

ACCA

Advanced Taxation
(ATX-UK)

Study Text

Finance Act 2023
for June 2024 to March 2025
examination sittings

KAPLAN PUBLISHING'S STATEMENT OF PRINCIPLES

LINGUISTIC DIVERSITY, EQUALITY AND INCLUSION

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We are here to make a difference to the success of every learner.

Clarity, accessibility and ease of use for our learners are key to our approach.

We will use contemporary examples that are rich, engaging and representative of a diverse workplace.

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We will seek to devise simple measures that can be used by independent assessors to randomly check our success in the implementation of our Linguistic Equality, Diversity and Inclusion Policy.

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These materials are reviewed by the ACCA examining team. The objective of the review is to ensure that the material properly covers the syllabus and study guide outcomes, used by the examining team in setting the exams, in the appropriate breadth and depth. The review does not ensure that every eventuality, combination or application of examinable topics is addressed by the ACCA Approved Content. Nor does the review comprise a detailed technical check of the content as the Approved Content Provider has its own quality assurance processes in place in this respect.

We are grateful to the Association of Chartered Certified Accountants for permission to reproduce past examination questions. The answers have been prepared by Kaplan Publishing.

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Introduction

How to use the Materials

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chances of success in your examinations.

The product range contains a number of features to help you in the study process. They include:

- (1) Detailed study guide and syllabus objectives
- (2) Description of the examination
- (3) Study skills and revision guidance
- (4) Tax rates and allowances
- (5) Study text or Integrated Workbook
- (6) Question practice

The sections on the study guide, the syllabus objectives, the examination and study skills should all be read before you commence your studies. They are designed to familiarise you with the nature and content of the examination and give you tips on how to best to approach your learning.

The **Study Text** comprises the main learning materials and gives guidance as to the importance of topics and where other related resources can be found. Each chapter includes:

- The **learning objectives** contained in each chapter, which have been carefully mapped to the examining body's own syllabus learning objectives or outcomes. You should use these to check you have a clear understanding of all the topics on which you might be assessed in the examination.
- The **chapter diagram** provides a visual reference for the content in the chapter, giving an overview of the topics and how they link together.
- The **content** for each topic area commences with a brief explanation or definition to put the topic into context before covering the topic in detail. You should follow your studying of the content with a review of the illustration/s. These are worked examples which will help you to understand better how to apply the content for the topic.
- **Test your understanding** sections provide an opportunity to assess your understanding of the key topics by applying what you have learned to short questions. Answers can be found at the back of each chapter.
- **Summary diagrams** complete each chapter to show the important links between topics and the overall content of the exam. These diagrams should be used to check that you have covered and understood the core topics before moving on.
- **Question practice** is provided at the back of the text.

Quality and accuracy are of the utmost importance to us so if you spot an error in any of our products, please send an email to mykaplanreporting@kaplan.com with full details, or follow the link to the feedback form in MyKaplan.

Our Quality Coordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

Icon Explanations



Definition – Key definitions that you will need to learn from the core content.



Key point – Identifies topics that are key to success and are often examined.



Helpful tutor tips – These sections give tips on the examinability of topics and whether information is provided in the tax rates and allowances in the examination.



Supplementary reading – These sections will help to provide a deeper understanding of core areas. The supplementary reading is **NOT** optional reading. It is vital to provide you with the breadth of knowledge you will need to address the wide range of topics within your syllabus that could feature in an exam question. **Reference to this text is vital when self-studying.**



Test your understanding – Exercises for you to complete to ensure that you have understood the topics just learned.



Illustration – Worked examples help you understand the core content better.



Tricky topic – When reviewing these areas care should be taken and all illustrations and test your understanding exercises should be completed to ensure that the topic is understood.



New topic – This symbol indicates new areas of study, building on knowledge gained from previous studies or the introduction of a completely new topic.



Links to other syllabus areas – This symbol refers to areas of interaction with other parts of your syllabus, either in terms of other ACCA exams that you have studied, or may go on to study, or even further professional qualifications that you may decide to pursue on completion of ACCA.

Online subscribers

Our online resources are designed to increase the flexibility of your learning materials and provide you with immediate feedback on how your studies are progressing.

If you are subscribed to our online resources, you will find:

- (1) Online reference material: reproduces your Study Text online, giving you anytime, anywhere access.
- (2) Online testing: provides you with additional online objective testing so you can practice what you have learned further.
- (3) Online performance management: immediate access to your online testing results. Review your performance by key topics and chart your achievement through the course relative to your peer group.

Ask your local student experience staff if you are not already a subscriber and wish to join.

Exam background

The aim of ACCA **Advanced Taxation (ATX-UK)**, is to apply relevant knowledge and skills and exercise professional judgement in providing relevant information and advice to individuals and businesses on the impact of the major taxes on financial decisions and situations.

Main capabilities

On the successful completion of this exam candidates should be able to:

- Apply further knowledge and understanding of the UK tax system through the study of more advanced topics within the taxes studied previously and the study of stamp taxes.
- Identify and evaluate the impact of relevant taxes on various situations and courses of action, including the interaction of taxes.
- Provide advice on minimising and/or deferring tax liabilities by the use of standard tax planning measures.
- Apply a range of professional skills in addressing requirements within the ATX-UK exam, and in preparation for, or to support, current work experience.
- Apply employability and technology skills.

ACCA Performance Objectives

In order to become a member of the ACCA, as a trainee accountant you will need to demonstrate that you have achieved nine performance objectives. Performance objectives are indicators of effective performance and set the minimum standard of work that trainees are expected to achieve and demonstrate in the workplace. They are divided into key areas of knowledge which are closely linked to the exam syllabus.

There are five Essential performance objectives and a choice of 17 Technical performance objectives which are divided into seven areas.

The performance objectives which link to this exam are:

- 1 Ethics and professionalism (Essential)
- 2 Tax computations and assessments (Technical)
- 3 Tax compliance and verification (Technical)
- 4 Tax planning and advice (Technical)

The following link provides an in-depth insight into all of the performance objectives:

https://www.accaglobal.com/content/dam/ACCA_Global/Students/per/PER-Performance-objectives-achieve.pdf

Progression

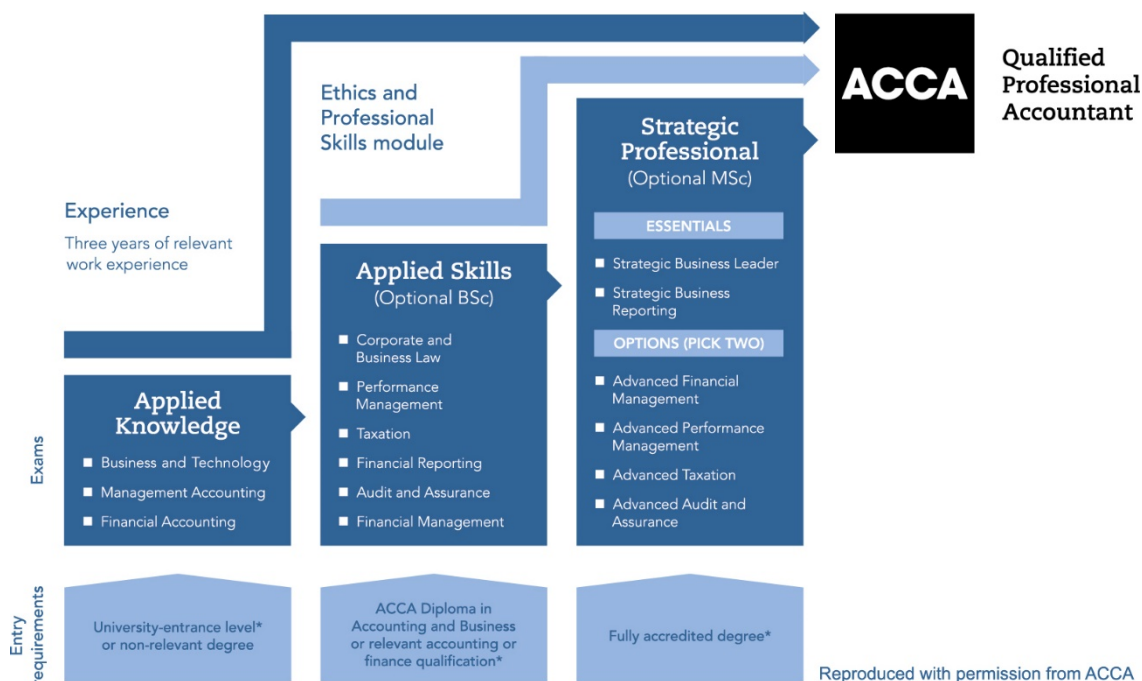
There are two elements of progression that we can measure: first how quickly students move through individual topics within a subject; and second how quickly they move from one course to the next. We know that there is an optimum for both, but it can vary from subject to subject and from student to student. However, using data and our experience of student performance over many years, we can make some generalisations.

A fixed period of study set out at the start of a course with key milestones is important. This can be within a subject, for example 'I will finish this topic by 30 June', or for overall achievement, such as 'I want to be qualified by the end of next year'.

Your qualification is cumulative, as earlier exams provide a foundation for your subsequent studies, so do not allow there to be too big a gap between one subject and another. We know that exams encourage techniques that lead to some degree of short-term retention, the result being that you will simply forget much of what you have already learned unless it is refreshed (look up Ebbinghaus Forgetting Curve for more details on this). This makes it more difficult as you move from one subject to another: not only will you have to learn the new subject, you will also have to relearn all the underpinning knowledge as well. This is very inefficient and slows down your overall progression which makes it more likely you may not succeed at all.

In addition, delaying your studies slows your path to qualification which can have negative impacts on your career, postponing the opportunity to apply for higher level positions and therefore higher pay.

You can use the following diagram showing the whole structure of your qualification to help you keep track of your progress.



Syllabus objectives

We have reproduced the ACCA's syllabus below, showing where the objectives are explored within this book. Within the chapters, we have broken down the extensive information found in the syllabus into easily digestible and relevant sections, called Content Objectives. These correspond to the objectives at the beginning of each chapter.

Syllabus learning objective

Chapter reference

A APPLY FURTHER KNOWLEDGE AND UNDERSTANDING OF THE UK TAX SYSTEM THROUGH THE STUDY OF MORE ADVANCED TOPICS WITHIN THE TAXES STUDIED PREVIOUSLY AND THE STUDY OF STAMP TAXES

(1) Income and income tax liabilities in situations involving further overseas aspects and in relation to trusts, and the application of exemptions and reliefs

(a) The contents of the Taxation – United Kingdom (TX-UK) study guide for income tax and national insurance, under headings:^[2]

- B1 The scope of income tax
- B2 Income from employment
- B3 Income from self-employment
- B4 Property and investment income
- B5 The comprehensive computation of taxable income and the income tax liability
- B6 National insurance contributions for employed and self-employed persons
- B7 The use of exemptions and reliefs in deferring and minimising income tax liabilities

The following additional material is also examinable:

(b) The scope of income tax:^[3]

- | | |
|--|-----------|
| (i) Explain and apply the concepts of residence, domicile and deemed domicile and advise on their relevance to income tax | 20 |
| (ii) Advise on the availability of the remittance basis to UK resident individuals who are neither UK domiciled nor deemed domiciled | 20 |
| (iii) Advise on the tax position of individuals coming to and leaving the UK | 20 |
| (iv) Determine the income tax treatment of overseas income from trading, employment and investment | 20 |
| (v) Understand the relevance of the OECD model double tax treaty to given situations | 20 |
| (vi) Calculate and advise on the double taxation relief available to individuals | 20 |

Syllabus learning objective**Chapter
reference**

- (c) Income from employment:^[3]
 - (i) Advise on the tax treatment of share option and share incentive schemes **17**
 - (ii) Advise on the tax treatment of lump sum receipts **17**
 - (iii) Identify personal service companies and advise on the tax consequences of services being provided via a personal service company **24**
- (d) Income from self-employment:^[3]
 - (i) Advise on the relief available for trading losses following the transfer of a business to a company **22**
 - (ii) Advise on the allocation of the annual investment allowance between related businesses **21**
- (e) Property and investment income:^[3]
 - (i) Advise on the tax implications of jointly held assets **16**
 - (ii) Recognise the tax treatment of savings income paid net of tax **16**
 - (iii) Income from trusts and settlements: Understand the income tax position of trust beneficiaries **13**
- (f) The comprehensive computation of taxable income and the income tax liability:^[3]
 - (i) Understand the allocation of the personal allowance to different categories of income **16**
 - (ii) Advise on the income tax position of the income of minor children **16**
- (g) The use of exemptions and reliefs in deferring and minimising income tax liabilities:
 - (i) Understand and apply the rules relating to investments in the seed enterprise investment scheme and the enterprise investment scheme^[3] **18**
 - (ii) Understand and apply the rules relating to investments in venture capital trusts^[3] **18**
 - (iii) Recognise the threshold level of income below which tapering of the pensions annual allowance does not apply^[2] **19**

Syllabus learning objective

Chapter reference

(2) Chargeable gains and capital gains tax liabilities in situations involving further overseas aspects and in relation to closely related persons and trusts together with the application of additional exemptions and reliefs

- (a) The contents of the Taxation – United Kingdom (TX-UK) study guide for chargeable gains for individuals under headings:^[2]
- C1 The scope of the taxation of capital gains
 - C2 The basic principles of computing gains and losses
 - C3 Gains and losses on the disposal of movable and immovable property
 - C4 Gains and losses on the disposal of shares and securities
 - C5 The computation of capital gains tax
 - C6 The use of exemptions and reliefs in deferring and minimising tax liabilities arising on the disposal of capital assets

The following additional material is also examinable:

- (b) The scope of the taxation of capital gains:^[3]
- | | |
|--|-----------|
| (i) Determine the tax implications of independent taxation and transfers between spouses | 7 |
| (ii) Identify the concepts of residence, domicile and deemed domicile and determine their relevance to capital gains tax | 20 |
| (iii) Advise on the availability of the remittance basis to UK resident individuals who are neither UK domiciled nor deemed domiciled ^[2] | 20 |
| (iv) Determine the UK taxation of foreign gains, including double taxation relief | 20 |
| (v) Conclude on the capital gains tax position of individuals coming to and leaving the UK | 20 |
| (vi) Advise on the UK taxation of gains on the disposal of UK land and buildings owned by non-residents | 20 |
| (vii) Identify the occasions when a capital gain would arise on a partner in a partnership on the disposal of a partnership asset | 23 |

Syllabus learning objective**Chapter
reference**

- (c) Capital gains tax and trusts:
 - (i) Advise on the capital gains tax implications of transfers of property into trust^[3]
 - (ii) Advise on the capital gains tax implications of property passing absolutely from a trust to a beneficiary^[2]
- (d) The basic principles of computing gains and losses:^[3]
 - (i) Identify connected persons for capital gains tax purposes and advise on the tax implications of transfers between connected persons
 - (ii) Advise on the impact of dates of disposal
 - (iii) Evaluate the use of capital losses in the year of death
- (e) Gains and losses on the disposal of movable and immovable property:^[3]
 - (i) Extend the explanation of part disposals to include small part disposals of land
 - (ii) Determine the gain on the disposal of leases and wasting assets
 - (iii) Extend the explanation of the treatment of assets damaged, lost or destroyed to include capital sums received
 - (iv) Advise on the tax effect of making negligible value claims
- (f) Gains and losses on the disposal of shares and securities:^[3]
 - (i) Extend the explanation of the treatment of rights issues to include the small part disposal rules applicable to rights issues
 - (ii) Define a qualifying corporate bond (QCB), and understand what makes a corporate bond non-qualifying. Understand the capital gains tax implications of the disposal of QCBs in exchange for cash or shares
 - (iii) Apply the rules relating to reorganisations, reconstructions and amalgamations and advise on the most tax efficient options available in given circumstances
 - (iv) Establish the relief for capital losses on shares in unquoted trading companies

6, 13**13****7****7****6****7****7****7****6****8****8****8****8**

Syllabus learning objective	Chapter reference
(g) The use of exemptions and reliefs in deferring and minimising tax liabilities arising on the disposal of capital assets: ^[3]	
(i) Understand and apply enterprise investment scheme reinvestment relief	18
(ii) Understand and apply seed enterprise investment scheme reinvestment relief	18
(iii) Advise on the availability of business asset disposal relief in relation to associated disposals	9
(iv) Understand and apply the relief that is available on the transfer of an unincorporated business to a limited company	22
(v) Understand the capital gains tax implications of the variation of wills	12
(3) Inheritance tax in situations involving further aspects of the scope of the tax and the calculation of the liabilities arising, the principles of valuation and the reliefs available, transfers of property to and from trusts, overseas aspects and further aspects of administration	
(a) The contents of the Taxation – United Kingdom (TX-UK) study guide for inheritance tax under headings: ^[2]	
– D1 The basic principles of computing transfers of value	
– D2 The liabilities arising on the chargeable lifetime transfers and on the death of an individual	
– D3 The use of exemptions in deferring and minimising inheritance tax liabilities	
– D4 Payment of inheritance tax	
The following additional material is also examinable:	
(b) The scope of inheritance tax:	
(i) Explain the concepts of domicile and deemed domicile and understand the application of these concepts to inheritance tax ^[2]	10, 12
(ii) Identify excluded property ^[2]	10
(iii) Identify and advise on the tax implications of the location of assets ^[3]	12
(iv) Identify and advise on gifts with reservation of benefit ^[3]	12

Syllabus learning objective**Chapter
reference**

- (c) The basic principles of computing transfers of value:
 - (i) Advise on the principles of valuation including the related property rules^[3] **11**
 - (ii) Advise on the availability of business property relief and agricultural property relief^[3] **11**
 - (iii) Identify exempt transfers^[2] **10**
- (d) The liabilities arising on chargeable lifetime transfers and on the death of an individual:^[3]
 - (i) Advise on the tax implications of chargeable lifetime transfers **10**
 - (ii) Advise on the tax implications of transfers within seven years of death **10**
 - (iii) Advise on the tax liability arising on a death estate **11**
 - (iv) Understand and apply the tapered withdrawal of the residence nil rate band where the net value of the estate exceeds £2 million **10**
 - (v) Advise on the relief for the fall in value of lifetime gifts **10**
 - (vi) Advise on the operation of quick succession relief **11**
 - (vii) Advise on the operation of double tax relief for inheritance tax **12**
 - (viii) Advise on the inheritance tax effects and advantages of the variation of wills **12**
 - (ix) Advise on the reduced rate of inheritance tax payable when a proportion of a person's estate is bequeathed to charity **11**
- (e) The liabilities arising in respect of transfers to and from trusts and on property within trusts:
 - (i) Define a trust^[2] **13**
 - (ii) Distinguish between different types of trust^[3] **13**
 - (iii) Advise on the inheritance tax implications of transfers of property into trust^[3] **13**
 - (iv) Advise on the inheritance tax implications of property passing absolutely from a trust to a beneficiary^[2] **13**
 - (v) Identify the occasions on which inheritance tax is payable by trustees^[3] **13**

Syllabus learning objective	Chapter reference
(f) The use of exemptions and reliefs in deferring and minimising inheritance tax liabilities: ^[3]	
(i) Advise on the use of reliefs and exemptions to minimise inheritance tax liabilities, as mentioned in the sections above	10, 11, 12, 13
(g) The system by which inheritance tax is administered, including the instalment option for the payment of tax:	
(i) Identify the occasions on which inheritance tax may be paid by instalments. ^[2]	12
(ii) Advise on the due dates, interest and penalties for inheritance tax purposes. ^[3]	12
(4) Corporation tax liabilities in situations involving further overseas and group aspects and in relation to special types of company, and the application of additional exemptions and reliefs	
(a) The contents of the Taxation – United Kingdom (TX-UK) study guide, for corporation tax, under headings: ^[2]	
– E1 The scope of corporation tax	
– E2 Taxable total profits	
– E3 Chargeable gains for companies	
– E4 The comprehensive computation of the corporation tax liability	
– E5 The effect of a group corporate structure for corporation tax purposes	
– E6 The use of exemptions and reliefs in deferring and minimising corporation tax liabilities	
The following additional material is also examinable:	
(b) The scope of corporation tax: ^[3]	
(i) Identify and calculate corporation tax for companies with investment business.	2
(ii) Close companies:	
– Apply the definition of a close company to given situations	24
– Conclude on the tax implications of a company being a close company or a close investment holding company	24

Syllabus learning objective**Chapter
reference**

- | | |
|--|-----------|
| (iii) Identify and evaluate the significance of accounting periods on administration or winding up | 1 |
| (iv) Conclude on the tax treatment of returns to shareholders after winding up has commenced | 24 |
| (v) Advise on the tax implications of a purchase by a company of its own shares | 24 |
| (vi) Identify personal service companies and advise on the tax consequences of services being provided via a personal service company | 24 |
| (c) Taxable total profits: ^[3] | |
| (i) Identify qualifying research and development expenditure, both capital and revenue, and determine the reliefs available for small or medium sized enterprises (SMEs) | 2 |
| (ii) Determine the tax treatment of non-trading deficits on loan relationships | 3 |
| (iii) Recognise the alternative tax treatments of intangible assets and conclude on the best treatment for a given company | 2 |
| (iv) Advise on the impact of the transfer pricing and thin capitalisation rules on companies | 2 |
| (v) Advise on the restriction on the use of losses on a change in ownership of a company | 3 |
| (vi) Identify the restriction on carried forward trading losses and capital losses for companies with profits over £5 million | 3 |
| (d) The comprehensive calculation of the corporation tax liability: ^[3] | |
| (i) Assess the impact of the OECD model double tax treaty on corporation tax | 5 |
| (ii) Evaluate the meaning and implications of a permanent establishment | 5 |
| (iii) Identify and advise on the tax implications of controlled foreign companies | 5 |
| (iv) Advise on the tax position of overseas companies trading in the UK | 5 |
| (v) Calculate double taxation relief | 5 |

Syllabus learning objective

Chapter reference

- (e) The effect of a group structure for corporation tax purposes:^[3]
 - (i) Advise on the allocation of the annual investment allowance between group or related companies **2**
 - (ii) Advise on the tax consequences of a transfer of intangible assets **4**
 - (iii) Advise on the tax consequences of a transfer of a trade and assets where there is common control **4**
 - (iv) Understand the meaning of consortium owned company and consortium member **4**
 - (v) Advise on the operation of consortium relief **4**
 - (vi) Determine pre-entry losses and understand their tax treatment **4**
 - (vii) Determine the degrouping charge where a company leaves a group within six years of receiving an asset by way of a no gain/no loss transfer **4**
 - (viii) Determine the effects of the anti-avoidance provisions, where arrangements exist for a company to leave a group **4**
 - (ix) Advise on the tax treatment of an overseas branch **5**
- (f) The use of exemptions and reliefs in deferring and minimising corporation tax liabilities:^[3]
 - (i) Determine the application of the substantial shareholdings exemption **2**
- (5) **Stamp taxes (stamp duty, stamp duty reserve tax, and stamp duty land tax)**
 - (a) The scope of stamp taxes:^[3]
 - (i) Identify the property in respect of which stamp taxes are payable. **6, 8**
 - (b) Identify and advise on the liabilities arising on transfers:^[3]
 - (i) Advise on the stamp taxes payable on transfers of shares and securities **8**
 - (ii) Advise on the stamp taxes payable on transfers of land **6**

Syllabus learning objective

Chapter reference

- (c) The use of exemptions and reliefs in deferring and minimising stamp taxes:^[3]
 - (i) Identify transfers involving no consideration **6, 8**
 - (ii) Advise on group transactions **4**
- (6) **Value added tax, tax administration and the UK tax system:**
 - (a) The contents of the Taxation – United Kingdom (TX-UK) study guide for value added tax (VAT) under headings: ^[2]
 - F1 The VAT registration requirements
 - F2 The computation of VAT liabilities
 - F3 The effect of special schemes

The following additional material is also examinable:

 - (i) Advise on the VAT implications of the supply of land and buildings in the UK **26**
 - (ii) Advise on the VAT implications of partial exemption **26**
 - (iii) Advise on the application of the capital goods scheme **26**
 - (b) The contents of the Taxation – United Kingdom (TX-UK) study guide for the UK tax system and its administration under headings: ^[2]
 - A1 The overall function and purpose of taxation in a modern economy
 - A2 Principal sources of revenue law and practice
 - A3 The systems for self-assessment and the making of returns
 - A4 The time limits for the submission of information, claims and payment of tax, including payments on account
 - A5 The procedures relating to compliance checks, appeals and disputes
 - A6 Penalties for non-compliance

The following additional material is also examinable: ^[2]

 - (i) Advise on the increased penalties which apply in relation to offshore matters **14**

Syllabus learning objective	Chapter reference
B THE IMPACT OF RELEVANT TAXES ON VARIOUS SITUATIONS AND COURSES OF ACTION, INCLUDING THE INTERACTION OF TAXES	
(1) Identify and advise on the taxes applicable to a given course of action and their impact.^[3]	4, 12, 21, 22, 24
(2) Identify and understand that the alternative ways of achieving personal or business outcomes may lead to different tax consequences.	4, 21, 22
(a) Calculate the receipts from a transaction, net of tax and compare the results of alternative scenarios and advise on the most tax efficient course of action. ^[3]	21
(3) Advise how taxation can affect the financial decisions made by businesses (corporate and unincorporated) and by individuals	
(a) Understand and compare and contrast the tax treatment of the sources of finance and investment products available to individuals. ^[3]	18
(b) Understand and explain the tax implications of the raising of equity and loan finance. ^[3]	25
(c) Explain the tax differences between decisions to lease, use hire purchase or purchase outright. ^[3]	25
(d) Understand and explain the impact of taxation on the cash flows of a business. ^[3]	1, 25
(4) Assess the tax advantages and disadvantages of alternative courses of action.^[3]	4, 12, 21, 22, 24
(5) Understand the statutory obligations imposed in a given situation, including any time limits for action and advising on the implications of non-compliance.^[3]	3, 4, 15, 21, 24, 27

Syllabus learning objective	Chapter reference
C MINIMISE AND/OR DEFER TAX LIABILITIES BY THE USE OF STANDARD TAX PLANNING MEASURES	
(1) Identify and advise on the types of investment and other expenditure that will result in a reduction in tax liabilities for an individual and/or a business. ^[3]	18, 21, 24, 25
(2) Advise on legitimate tax planning measures, by which the tax liabilities arising from a particular situation or course of action can be mitigated. ^[3]	3, 4, 12, 18, 21, 22, 24
(3) Advise on the appropriateness of such investment, expenditure or measures given a particular taxpayer's circumstances or stated objectives. ^[3]	4, 18, 21, 24
(4) Advise on the mitigation of tax in the manner recommended by reference to numerical analysis and/or reasoned argument. ^[3]	3, 4, 18, 21, 24
(5) Be aware of the ethical and professional issues arising from the giving of tax planning advice. ^[3]	14, 24
D PROFESSIONAL SKILLS	
(1) Communication	
(a) Inform concisely, objectively and unambiguously, adopting a suitable style and format, using appropriate technology. ^[3]	28
(b) Advise using compelling and logical arguments, demonstrating the ability to counter argue where appropriate. ^[3]	28
(c) Clarify and simplify complex issues to convey relevant information in a way that adopts an appropriate tone and is easily understood and reflects the requirements of the intended audience. ^[3]	28
(2) Analysis and evaluation	
(a) Investigate relevant information from a range of sources, using appropriate analytical techniques to establish reasons and causes of issues, assist in decision-making and to identify opportunities or solutions. ^[3]	28
(b) Consider information, evidence and findings carefully, reflecting on their implications and how they can be used to best support the interests of the individual, entity or wider business organisation. ^[3]	28

Syllabus learning objective	Chapter reference
(c) Assess and apply appropriate judgement when considering ethical, professional or other technical issues; when making conclusions or recommendations, taking into account the implications of such decisions on the entity or individual affected. ^[3]	28
(d) Appraise information objectively in order to effectively prioritise issues; identifying missing information and exploring suitable alternatives when making decisions, devising courses of action or providing conclusions or recommendations. ^[3]	28
(e) Communicate conclusions reached, together, where necessary with relevant supporting computations. ^[3]	28
(3) Scepticism	
(a) Explore the underlying reasons for issues, applying an attitude of a questioning mind where appropriate, beyond what is immediately apparent. ^[3]	28
(b) Question opinions, assertions and assumptions, by seeking justifications and obtaining sufficient evidence for either their support and acceptance or rejection. ^[3]	28
(c) Challenge and critically assess the information presented or decisions or recommendations made, where this is clearly justified, in the wider professional, ethical, organisational or public interest. ^[3]	28
(d) State and explain assumptions made or limitations in the analysis provided; together with any inadequacies in the information available and/or additional information required to provide a fuller analysis. ^[3]	28
(4) Commercial acumen	
(a) Demonstrate awareness of organisational and external and other non-tax factors which will affect decisions with regard to tax taken by an individual or entity. ^[3]	28
(b) Recognise key issues in a given scenario and use judgement in proposing and recommending commercially viable solutions. ^[3]	28
(c) Offer solutions which are practical and commercial in the context of the scenario being considered. ^[3]	28
(d) Show insight and perception in understanding key tax drivers of an individual or entity, demonstrating acumen in arriving at appropriate recommendations. ^[3]	28

Syllabus learning objective	Chapter reference
E EMPLOYABILITY AND TECHNOLOGY SKILLS	
(1) Use computer technology to efficiently access and manipulate relevant information	29
(2) Work on relevant response options, using available functions and technology, as would be required in the workplace	29
(3) Navigate windows and computer screens to create and amend responses to exam requirements, using the appropriate tools	29
(4) Present data and information effectively, using the appropriate tools	29

The superscript numbers in square brackets indicate the intellectual level at which the subject area could be assessed within the examination.

Level 1 (knowledge and comprehension) broadly equates with the Applied Knowledge level.

Level 2 (application and analysis) with the Applied Skills level.

Level 3 (synthesis and evaluation) to the Strategic Professional level.

However, lower level skills can continue to be assessed as you progress through each level.

The Examination

Examination format

The exam will feature three multi-tax questions. An analysis of the marks available for each of these questions is set out below:

	Section A	Section B		
	Q1	Q2	Q3	Total
Technical marks	40	20	20	80
Professional skills marks	10	5	5	20
	<hr/>	<hr/>	<hr/>	<hr/>
	50	25	25	100
	<hr/>	<hr/>	<hr/>	<hr/>

The Section A question will be a case-study consisting of a number of exhibits. The 50 marks will comprise of 35 technical marks, 5 ethics marks and 10 professional skills marks.

The two compulsory Section B questions will generally consist of a single exhibit of information and a set of requirements.

Candidates will be expected to undertake both calculation and narrative work. The questions will be scenario based and may involve consideration of more than one tax, some elements of planning and the interaction of taxes.

Tax rates, allowances and information on certain reliefs will be given in the exam.

Total time allowed: 3 hours and 15 minutes.

The pass mark is 50%.

Remote invigilated exams

In certain geographical areas it may be possible for you to take your exam remotely. This option, which is subject to strict conditions, can offer increased flexibility and convenience under certain circumstances. Further guidance, including the detailed requirements and conditions for taking the exam by this method, is contained on ACCA's website at <https://www.accaglobal.com/an/en/student/exam-entry-and-administration/about-our-exams/remote-exams/remote-session-exams.html>.

Professional skills

The 20 professional skills marks will be awarded for demonstrating the following skills:

- Communication
- Analysis and evaluation
- Scepticism
- Commercial acumen

The Section A question will examine all four of these skills.

The Section B questions will examine a combination of professional skills appropriate to the particular question. Each one will examine a minimum of two professional skills from analysis and evaluation, scepticism and commercial acumen. Communication skills will not be examined in Section B.

Examination tips

In addition to reading the tips contained here, we recommend that you review Chapter 29 of the Study Text and the resources available on the ACCA Global Website before sitting the CBE. Here you will find guidance documents, videos and a link to the CBE question practice platform.

Before the exam starts

You will be given ten minutes to read the introductory page and the four pages of instructions. These will be the same for each ATX exam and therefore it is important that you familiarise yourself with these (using the ACCA practice exams) during your revision. The exam time (3 hours and 15 minutes) will start automatically at the end of the 10 minutes or earlier if actioned by you.

Time allocation

The time allowed for this exam is 3 hours and 15 minutes (195 minutes).

Read each question carefully, reviewing the format and content of the requirements so that you understand what you need to do.

There are 80 technical marks and 20 professional skills marks. **Professional skills marks should be achieved as you work through the technical marks.**

If 15 minutes are spent reading the examination requirements (it may be sensible to allocate time to this), your time allocation should be 2.25 minutes per mark (180/80). This gives 90 minutes for section A and 45 minutes for each section B question.

If you do not allow a specific amount of time for reading and planning (a more straightforward approach but the risk is that you run out of time) your time allocation will be 2.4 minutes per mark (195/80). This gives 97 minutes for section A and 49 minutes for each section B question.

If you plan to spend more or less time on reading and planning, your time allocation per mark will be different.

Planning your answers

When the exam starts spend a few minutes skimming through each question to get a feel for what is included.

Once you have done this carry out an initial review of Section A. This will include a number of **exhibits** breaking down the scenario into relevant sections and including the detailed requirement in an 'email from your manager'. It will also include a list of the summarised **requirements**, which is given in the 'background information, and an option to complete your answer in a **word processing** document and/or a **spreadsheet** document.

You can move around and resize the windows that you open to lay the screen out in a format that suits you.

Now copy and paste the specifics of the requirement into your answer document, perhaps highlighting in bold the different parts of the requirement and the verb used. Once complete, review the exhibits in detail, highlighting and making notes as you do so and copy and pasting any relevant information to your answer document. These steps will help with your planning and structure but will also enable you to minimise the number of windows you have open.

A date assumption will be given at the start of each question. You should pay careful attention to this date and the timing of events noted in the scenario in relation to it. Some events may have already happened, whereas others may be planned for the future. For events which have already occurred reliefs may still be able to be claimed, but you need to consider if the relevant claim date has already passed. For future events there could be tax planning implications that could be discussed.

You can use the scratch pad to make notes as part of your planning, however any notes made here will not be marked. Candidates sitting via remote invigilation do not have the opportunity to use scrap paper and so the scratch pad is the only place rough workings or planning can be completed.

The procedure will be similar for Section B.

Completing your answers

Start by revisiting the relevant exhibits for each requirement.

Stick to the question and **tailor your answer** to what you are asked. Pay particular attention to the verbs in the question (e.g. calculate, explain, advise, state, conclude).

Remember that the aim is to produce a professional and easy to read answer.

You should do everything you can to make things easy for the marker. The marker will find it easier to identify the points you have made if your answers are clearly set out and use appropriate headings.

Computations: For calculations and numerical work, use a logical and well laid out structure in a spreadsheet. Many computational questions require the use of a standard format. Be sure you know these formats thoroughly before the examination and use the layouts that you see in the answers given in this book and in model answers.

It is essential to include all your workings in your answers. Adopt a logical approach and cross reference workings to the main computation to keep your answer tidy and organised. Calculations should be labelled and referenced in to any relevant discussion in the word processor.

Written answers: For discursive answers, the word processor should be used and answers should include bold headings and sub-headings and professional language. Ensure all aspects of the requirement are addressed in a sensible and balanced way. It is vital that you relate your answer to the specific circumstances given.

Communication of information

It is important to use the appropriate format for the communication of information, both in real life and in the examination.

In the Section A scenario-type exam question, the examining team will tell you to present your answer in a specific format.

Reports, memos and other documents: Some questions ask you to present your answer in the form of a report or a memo or other document. So use the correct format – there are easy professional skills marks to gain here for communication.

Notes in preparation for a meeting: Some questions will ask candidates to produce notes in preparation for a meeting with a client or colleagues. These notes should be well organised with headings for different areas covered. They do not need to be in any specific format, but should be easy to follow and logical.

The scenario questions are often open-ended, and will usually require you to analyse information, work through a series of steps and provide advice. Sometimes you may be advising a client directly, or you may be providing information to your manager in preparation for a meeting with a client.

You may have to state assumptions if incomplete information is provided, and may have to identify further information to be requested from your client. This demonstrates the professional skill of scepticism. If you are asked to come to a conclusion, it is important that you do so – this shows the professional skill of analysis and evaluation. Label your conclusion clearly so that is easy for the marker to see.

If you **get completely stuck** with a question, leave space in your answer and **return to it later**. You can attempt the questions in any order that you wish.

If you do not understand what a question is asking, state your assumptions. Even if you do not answer in precisely the way the examining team would hope for, you should be given some credit, if your assumptions are reasonable.

Finally, leave enough time to read through the answers, ensuring they are clear and organised, and to make any necessary changes.

The questions provided in Chapter 30 at the end of this material are not full examination standard questions, but will enable you to build up to answering such questions. Most ‘real’ examination questions are multi-tax questions.

Full examination questions and answers with detailed guidance on how to approach each individual scenario, ‘walk through’ answers with tips and tutorial notes can be found in the Kaplan Publishing exam kit.

Strategic Professional CBE

It is essential that you become familiar with the CBE environment as part of your exam preparation. For additional support please refer to the ACCA Global website.

Study skills and revision guidance

This section aims to give guidance on how to study for your ACCA exams and to give ideas on how to improve your existing study techniques.

Preparing to study

Set your objectives

Before starting to study decide what you want to achieve – the type of pass you wish to obtain. This will decide the level of commitment and time you need to dedicate to your studies.

Devise a study plan

Determine which times of the week you will study.

Split these times into sessions of at least one hour for study of new material. Any shorter periods could be used for revision or practice.

Put the times you plan to study onto a study plan for the weeks from now until the exam and set yourself targets for each period of study – in your sessions make sure you cover the course, course assignments and revision.

If you are studying for more than one exam at a time, try to vary your subjects as this can help you to keep interested and see subjects as part of wider knowledge.

When working through your course, compare your progress with your plan and, if necessary, re-plan your work (perhaps including extra sessions) or, if you are ahead, do some extra revision/practice questions.

Effective studying

Active reading

You are not expected to learn the text by rote. However, you do need to learn the tax rules and have a firm grasp of a considerable amount of detail (e.g. the conditions to be satisfied). You must also understand what you are reading and be able to use the rules to pass the exam and develop good practice.

A good technique to use is SQ3Rs – Survey, Question, Read, Recall, Review:

- (1) **Survey the chapter** – look at the headings and read the introduction, summary and objectives, so as to get an overview of what the chapter deals with.
- (2) **Question** – whilst undertaking the survey, ask yourself the questions that you hope the chapter will answer for you.
- (3) **Read** – through the chapter thoroughly, answering the questions and making sure you can meet the objectives. Attempt the exercises and activities in the text, and work through all the examples.
- (4) **Recall** – at the end of each section and at the end of the chapter, try to recall the main ideas of the section/chapter without referring to the text. This is best done after a short break of a couple of minutes after the reading stage.
- (5) **Review** – check that your recall notes are correct, and make sure you have retained the facts and sufficient level of detail.

You may also find it helpful to re-read the chapter to try to see the topic(s) it deals with as a whole.

Note taking

Taking notes is a useful way of learning, but do not simply copy out the text. The notes must:

- be in your own words
- be concise
- cover the key points
- be well organised
- be modified as you study further chapters in this text or in related ones.

Trying to summarise a chapter without referring to the text can be a useful way of determining which areas you know and which you don't.

Three ways of taking notes:

- (1) **Summarise the key points of a chapter.**
- (2) **Make linear notes** – a list of headings, divided up with subheadings listing the key points. If you use linear notes, you can use different colours to highlight key points and keep topic areas together. Use plenty of space to make your notes easy to use.
- (3) **Try a diagrammatic form** – the most common of which is a mind map. To make a mind map, put the main heading in the centre of the paper and put a circle around it. Then draw short lines radiating from this to the main sub-headings, which again have circles around them. Then continue the process from the sub-headings to sub-sub-headings, advantages, disadvantages, etc.

Highlighting and underlining

You may find it useful to underline or highlight key points in your study text – but do be selective. You may also wish to make notes in the margins.

Revision

The best approach to revision is to revise the course as you work through it. Also try to leave four to six weeks before the examination for final revision. Make sure you cover the whole syllabus and pay special attention to those areas where your knowledge is weak. Here are some recommendations:

Read through the text and your notes again and condense your notes into key phrases. It may help to put key revision points onto index cards to look at when you have a few minutes to spare.

Review any assignments you have completed and look at where you lost marks – put more work into those areas where you were weak.

Practise examination standard questions under timed conditions. If you are short of time, list the points that you would cover in your answer and then read the model answer, but do try to complete at least a few questions under examination conditions.

Question practice using the ACCA practice platform is important. Here you can access the specimen exam and practice exams in the CBE layout, format and functionality which you will encounter in your real exam. It is very important that you practise as many questions as possible on the platform to familiarise yourself with how the software works.

Once you have completed questions in the practice platform your responses are saved, you can then self-mark them using marking guides and sample answers.

Also practise producing answer plans and comparing them to the model answer.

If you are stuck on a topic find somebody (a tutor) to explain it to you.

Read good newspapers and professional journals, especially ACCA's Student Accountant – this can give you an advantage in the exam.

Ensure you **know the structure of the exam** – how many questions and of what type you will be expected to answer. During your revision attempt all the different styles of questions you may be asked.

Further reading

You can find further reading and technical articles under the student section of ACCA's website.

Tax rates and allowances

Supplementary instructions

- 1 You should assume that the tax rates and allowances for the tax year 2023/24 and for the financial year to 31 March 2024 will continue to apply for the foreseeable future unless you are instructed otherwise.
- 2 Calculations and workings need only to be made to the nearest £.
- 3 All apportionments should be made to the nearest month.
- 4 All workings should be shown.

	Income tax	Normal rates	Dividend rates
Basic rate	£1 – £37,700	20%	8.75%
Higher rate	£37,701 – £125,140	40%	33.75%
Additional rate	£125,141 and over	45%	39.35%
Savings income nil rate band	– Basic rate taxpayers		£1,000
	– Higher rate taxpayers		£500
Dividend nil rate band			£1,000

A starting rate of 0% applies to savings income where it falls within the first £5,000 of taxable income.

Personal allowance

Personal allowance	£12,570
Transferable amount	£1,260
Income limit	£100,000

Where adjusted net income is £125,140 or more, the personal allowance is reduced to zero.

Residence status

Days in UK	Previously resident	Not previously resident
Less than 16	Automatically not resident	Automatically not resident
16 to 45	Resident if 4 UK ties (or more)	Automatically not resident
46 to 90	Resident if 3 UK ties (or more)	Resident if 4 UK ties
91 to 120	Resident if 2 UK ties (or more)	Resident if 3 UK ties (or more)
121 to 182	Resident if 1 UK tie (or more)	Resident if 2 UK ties (or more)
183 or more	Automatically resident	Automatically resident

Remittance basis charge

UK resident for:	Charge
Seven out of the last nine years	£30,000
12 out of the last 14 years	£60,000

Car benefit percentage

The relevant base level of CO₂ emissions is 55 grams per kilometre.

The percentage rates applying to petrol cars (and diesel cars meeting the RDE2 standard) with CO₂ emissions up to this level are:

51 grams to 54 grams per kilometre	15%
55 grams per kilometre	16%

The percentage for electric cars with zero CO₂ emissions is 2%.

For hybrid-electric cars with CO₂ emissions between 1 and 50 grams per kilometre, the electric range of a car is relevant.

130 miles or more	2%
70 to 129 miles	5%
40 to 69 miles	8%
30 to 39 miles	12%
Less than 30 miles	14%

Car fuel benefit

The base figure for calculating the car fuel benefit is £27,800.

Company van benefits

The company van benefit scale charge is £3,960, and the van fuel benefit is £757.

A van with zero CO₂ emissions does not give rise to a benefit.

Individual savings accounts (ISAs)

The overall investment limit is £20,000.

Rent-a-room relief

The rent-a-room relief limit is £7,500.

Pension scheme limits

Annual allowance	£40,000
Minimum allowance	£4,000
Threshold income limit	£200,000
Income limit	£240,000
Lifetime allowance	£1,073,100

The maximum contribution which can qualify for tax relief without any earnings is £3,600

Approved mileage allowances: cars

Up to 10,000 miles	45p
Over 10,000 miles	25p

Capital allowances: rates of allowance

Plant and machinery

Main pool	18%
Special rate pool	6%

Cars

New cars with zero CO ₂ emissions	100%
Second-hand cars with zero CO ₂ emissions	18%
CO ₂ emissions between 1 and 50 grams per kilometre	18%
CO ₂ emissions over 50 grams per kilometre	6%

Annual investment allowance

Rate of allowance	100%
Expenditure limit	£1,000,000

Structures and buildings allowance

Straight line allowance	3%
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Cash basis accounting

Revenue limit	£150,000
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Cap on income tax reliefs

Unless otherwise restricted, reliefs are capped at the higher of £50,000 or 25% of income.

Corporation tax

Financial year	2021	2022	2023
Small profits rate	N/A	N/A	19%
Main rate	19%	19%	25%
Lower limit	N/A	N/A	£50,000
Upper limit	N/A	N/A	£250,000
Standard fraction	N/A	N/A	3/200

Marginal relief

$$(\text{Upper limit} - \text{Augmented profits}) \times \text{Standard fraction} \times \frac{\text{Taxable total profits}}{\text{Augmented profits}}$$

Quarterly instalments

Profit threshold	£1,500,000
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Value added tax (VAT)

Standard rate	20%
Registration limit	£85,000
Deregistration limit	£83,000

Penalties for late VAT payments

Days late	Penalty
Up to 15 days	None
16 to 30 days	2%
More than 30 days	4% plus a 4% daily penalty

Inheritance tax: nil rate bands and tax rates

Nil rate band		£325,000
Residence nil rate band		£175,000
Rate of tax on excess	– Lifetime rate	20%
	– Death rate	40%

Inheritance tax: taper relief

Years before death	Percentage reduction
More than 3 but less than 4 years	20%
More than 4 but less than 5 years	40%
More than 5 but less than 6 years	60%
More than 6 but less than 7 years	80%

Capital gains tax: tax rates

	Normal rates	Residential property
Lower rate	10%	18%
Higher rate	20%	28%
Annual exempt amount		£6,000

Capital gains tax: business asset disposal relief and investors' relief

Lifetime limit	– business asset disposal relief	£1,000,000
Lifetime limit	– investors' relief	£10,000,000
Rate of tax		10%

National insurance contributions

Class 1 Employee	£1 – £12,570 per year	Nil
	£12,571 – £50,270 per year	12%
	£50,271 and above per year	2%
Class 1 Employer	£1 – £9,100 per year	Nil
	£9,101 and above per year	13.8%
	Employment allowance	£5,000
Class 1A		13.8%
Class 2	£3.45 per week	
	Lower profits limit	£12,570
Class 4	£1 – £12,570 per year	Nil
	£12,571 – £50,270 per year	9%
	£50,271 and above per year	2%

Rates of interest (assumed)

Official rate of interest	2.25%
Rate of interest on underpaid tax	6.50%
Rate of interest on overpaid tax	3.00%

Standard penalties for errors			
Taxpayer behaviour	Maximum penalty	Minimum penalty – unprompted disclosure	Minimum penalty – prompted disclosure
Deliberate and concealed	100%	30%	50%
Deliberate but not concealed	70%	20%	35%
Careless	30%	0%	15%

Stamp duty land tax on non-residential properties

Up to £150,000	0%
£150,001 – £250,000	2%
£250,001 and above	5%

Stamp duty

Shares	0.5%
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Corporation tax: Computations and administration

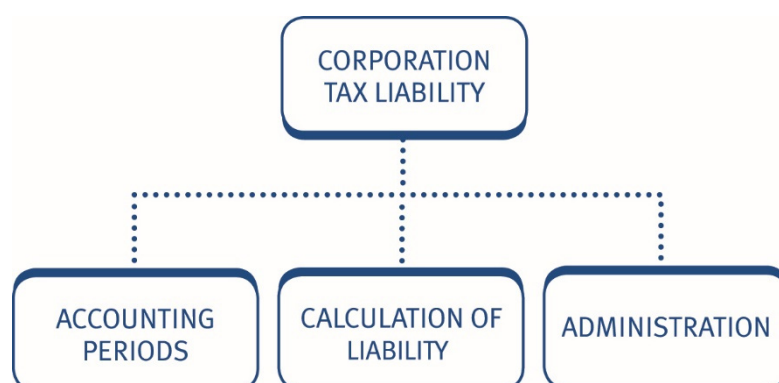
Chapter learning objectives

Upon completion of this chapter you will be able to:

- identify and evaluate the significance of accounting periods on administration or winding up
- prepare the corporation tax computation and liability for a UK resident company
- define associated companies and recognise the effect for corporation tax
- state when corporation tax is due for non-large companies and define a large company and explain how they are required to pay corporation tax on a quarterly basis
- understand and explain the impact of taxation on the cash flows of a business
- explain the principles of company self-assessment including the time limits for notifying/filing returns and claims and the penalties for non-compliance
- list the information and records that taxpayers need to retain for tax purposes together with the retention period.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. This includes calculating corporation tax, which is covered by this chapter. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This and the following two chapters deal with the way in which companies are subject to corporation tax.



This chapter sets out the basis of assessment and explains how a company's corporation tax liability is calculated. Much of this chapter is a revision of rules covered in TX.



The effective communication to clients of corporation tax payment dates, filing requirements and potential penalties is an important professional skill that may be tested in the ATX exam.

1 Corporation tax computation

Basis of assessment

UK resident companies are assessed to corporation tax on their **taxable total profits** (TTP) arising in an **accounting period** (AP).

TTP = income (excluding dividends received) **plus** net chargeable gains **less** qualifying charitable donations (QCDs).



Accounting period

- Accounting period (AP) = the period for which a charge to corporation tax is made
 - usually = 12 months and is the same as the company's period of account
 - can be less than 12 months
 - cannot exceed 12 months.

Note that a company's period of account is the period for which the company prepares its financial statements. It is usually 12 months but can be shorter or longer than 12 months.

In the exam, the term 'accounting reference date' will be used to describe the date to which the company's financial statements are prepared, otherwise known as the accounting date.

- If a company's period of account exceeds 12 months, it must be split into two corporation tax APs:
 - the first 12 months of the period of account
 - followed by the balance of the period of account = short AP.
- An AP **starts** when:
 - a company starts to trade, or
 - profits of a company first become liable to corporation tax, or
 - the previous AP ends.
- A new company must notify HMRC of its establishment **within three months** of the start of its first AP.

There is a separate obligation to notify HMRC of chargeability to tax **within 12 months** from the end of its AP.
- An AP **ends** on the earliest of:
 - **12 months after it started**
 - the end of the period of account (the accounting reference date)
 - when the company ceases to trade, to be UK resident or ceases to be liable to corporation tax
 - commences/ceases administration or winding up proceedings.



Illustration 1 – Accounting periods

Alder Ltd was incorporated on 15 July 2023 and started to trade on 1 September 2023. The company chose 30 June as its accounting reference date and prepared its first financial statements to 30 June 2024 and then for the 12 months to 30 June 2025.

State the dates of Alder Ltd's first two accounting periods.

Solution

First AP: 1 September 2023 – 30 June 2024
(date of commencing trade until end of period of account).

Second AP: 1 July 2024 – 30 June 2025
(immediately after the end of the previous AP until the accounting reference date).

Note: An AP does not start on the incorporation of the company.



Illustration 2 – Accounting periods

Fly plc has been trading for many years, preparing its financial statements to 31 December each year. The board of directors decided to change the accounting reference date to 30 April.

State the accounting periods for Fly plc if it prepared:

- (a) **one set of financial statements covering the sixteen months to 30 April 2025, or**
- (b) **two sets of financial statements covering the four months to 30 April 2024 and the twelve months to 30 April 2025.**

Solution

- (a) If one set of financial statements is prepared covering sixteen months:
 - it must be divided into:
 - a 12-month AP to 31 December 2024, and
 - a 4-month AP to 30 April 2025.
- (b) If two sets of financial statements are prepared:
 - the APs will be the same as the financial statements:
 - 4 months to 30 April 2024
 - 12 months to 30 April 2025.



Illustration 3 – Accounting periods on cessation

Wild Ltd has been trading for many years with a 30 June accounting reference date. Due to recent financial difficulties, it was decided that the company should be wound up.

Wild Ltd ceased trading on 31 December 2022 and on 30 April 2023 the winding up commenced. The winding up was completed on 31 March 2024.

State the dates of Wild Ltd's accounting periods from 1 July 2022 onwards.

Solution

1 July 2022 to 31 December 2022	(immediately after the end of the previous AP until cessation of trade)
1 January 2023 to 30 April 2023	(immediately after the end of the previous AP until commencement of winding up proceedings)
1 May 2023 to 31 March 2024	(immediately after the end of the previous AP until completion of winding up proceedings)

Note: The company's normal 30 June year end is ignored during the winding up process.

Pro forma corporation tax computation

Name of company

Corporation tax computation – for AP ended:

	£
Trading profits	X
Interest income	X
Property income	X
Miscellaneous income	X
Net chargeable gains	X
	<hr/>
Total profits	X
Less: Qualifying charitable donations (QCDs) (amount paid = gross amount)	(X)
	<hr/>
Taxable total profits (TTP)	X
	<hr/>
Corporation tax (CT) calculated at relevant rates	X
Less: Marginal relief (if applicable)	(X)
	<hr/>
Corporation tax liability	X
Less: Double taxation relief (DTR) (Chapter 5)	(X)
	<hr/>
Corporation tax payable	X
	<hr/>

Due date nine months and one day after end of AP (unless 'large company' which pays in instalments – section 3)

File date 12 months after end of period of account

Notes:

- (1) Trading profits, interest income and property income include income from overseas sources.
- (2) All income is included in the computation **gross**.
- (3) QCDs include **all** donations to charity by a company (except those allowed as a trading expense).
- (4) The detailed rules for calculating TTP are in Chapter 2.

2 The corporation tax liability

A company's corporation tax liability is calculated by applying the appropriate rate of corporation tax to the company's taxable total profits.

Determining the relevant rate of corporation tax

- The rate of corporation tax is determined by comparing a company's augmented profits to statutory limits.
- Augmented profits are calculated as follows:

	£
Taxable total profits (TTP)	X
Plus: Dividends received from non-group companies	X
	<hr/>
Augmented profits	X
	<hr/>

Dividends received

Although dividends received from UK and overseas companies are exempt from corporation tax, they can have an impact on the rate of tax that the company pays and also whether corporation tax needs to be paid by instalments (see section 3).

- The amount of cash dividends received is added to TTP in order to arrive at the augmented profits figure.
- Dividends received from an overseas company are included, but they may have been subject to tax in the overseas country. Any overseas tax suffered is ignored. Accordingly, only the actual cash received is included in this calculation (in the same way as UK dividends).
- Dividends received from associated companies (explained later in this section) are also ignored in the calculation.

Calculating the corporation tax liability

- The rate of corporation tax is fixed by reference to financial years.
- A financial year runs from 1 April to the following 31 March and is identified by the calendar year in which it begins.
- The year commencing 1 April 2023 and ending on 31 March 2024 is the Financial Year 2023 (FY2023).



Financial years should not be confused with tax years for personal taxes, which run from 6 April to the following 5 April.

- The rates of corporation tax needed for the ATX exam are:

Financial year	2021	2022	2023
Small profits rate	N/A	N/A	19%
Main rate	19%	19%	25%
Lower limit	N/A	N/A	£50,000
Upper limit	N/A	N/A	£250,000
Standard fraction	N/A	N/A	3/200

- The relevant rate is found by comparing the augmented profits to the upper and lower limits.
- The limits may need to be adjusted as follows:
 - Short AP: time apportion
 - Associated companies: divide by the number of associated companies in the group

Marginal relief

Marginal relief is available if augmented profits fall between the upper and lower limits and is calculated as follows:

$$(\text{Upper limit} - \text{augmented profits}) \times \text{Standard fraction} \times \frac{\text{Taxable total profits}}{\text{Augmented profits}}$$



The rates of corporation tax and formula for calculating marginal relief are included in the tax rates and allowances provided to you in the examination.



Illustration 4 – Corporation tax liability

Sycamore Ltd has the following results for the year ended 31 March 2024:

TTP	£150,000
Dividends received from unconnected companies	£30,000

Calculate the corporation tax liability for Sycamore Ltd.

Solution

	£
TTP	150,000
Plus: Dividends received	30,000
	<hr/>
Augmented profits	180,000
	<hr/>

The AP all falls into FY2023.

Marginal relief applies as augmented profits are between the limits.

	£
Corporation tax on TTP ($£150,000 \times 25\%$)	37,500
Less: Marginal relief	
$(£250,000 - £180,000) \times 3/200 \times £150,000/£180,000$	(875)
Corporation tax liability	<u>36,625</u>



Illustration 5 – Corporation tax liability for short AP

Elm Ltd has the following results for the nine months ended 31 March 2024:

TTP	£150,000
Dividends received from unconnected companies	£30,000

Calculate the corporation tax liability for Elm Ltd.

Solution

	£
TTP	150,000
Plus: Dividends received	30,000
Augmented profits	<u>180,000</u>

The AP all falls into FY2023.

The upper and lower limits must be scaled down as the AP is only nine months.

Lower limit ($£50,000 \times 9/12$)	£37,500
Upper limit ($£250,000 \times 9/12$)	£187,500

Marginal relief applies as augmented profits are between the limits.

	£
Corporation tax on TTP ($£150,000 \times 25\%$)	37,500
Less: Marginal relief	
$(£187,500 - £180,000) \times 3/200 \times £150,000/£180,000$	(94)
Corporation tax liability	<u>37,406</u>

Accounting periods straddling 31 March

When a company's AP falls into two financial years, the corporation tax liability must be calculated for each financial year separately if either of the following change:

- the corporation tax rates, or
- the statutory limits.

The statutory limits and the rates of corporation tax changed on 1 April 2023.

Therefore, a two part computation is required for an AP straddling 31 March 2023.

The corporation tax liability must be calculated separately for each financial year applying the appropriate rates of tax to each.



Illustration 6 – AP straddling 31 March

Oboe Ltd has the following results for the year ended 31 December 2023:

TTP	£300,000
Dividends received from unconnected companies	£20,000

Calculate the corporation tax liability for Oboe Ltd.

Solution

	£
TTP	300,000
Plus: Dividends received	20,000
	<hr/>
Augmented profits	320,000
	<hr/>

The AP straddles 31 March 2023.

As augmented profits are above the upper limit of £250,000 the main rate applies.

Three months (1 January 2023 to 31 March 2023) fall into FY2022 and nine months (1 April 2023 to 31 December 2023) fall into FY2023.

The corporation tax liability is calculated as follows:

	£
FY2022 ($£300,000 \times 19\% \times 3/12$)	14,250
FY2023 ($£300,000 \times 25\% \times 9/12$)	56,250
	<hr/>
Corporation tax liability	70,500
	<hr/>



Test your understanding 1

Flute Ltd has TTP of £75,000 and receives dividends from non-group companies of £15,000 in the year ended 30 September 2023.

Calculate Flute Ltd's corporation tax liability for the year ended 31 September 2023.

Associated companies



Two companies are associated companies if:

- One company controls the other(s), or
- Both are controlled by the same 'person' (company or individual).

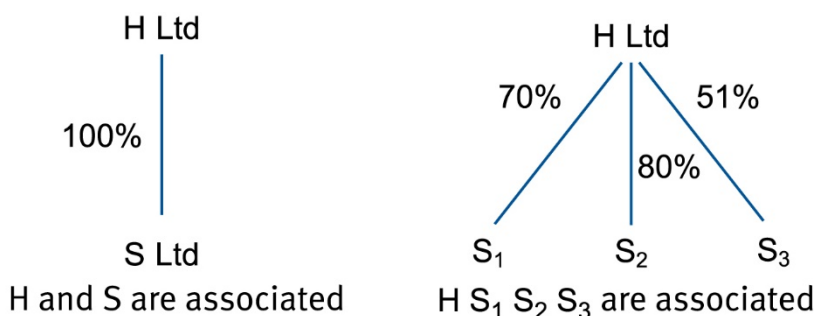
Control

Control means that the person has > 50% of

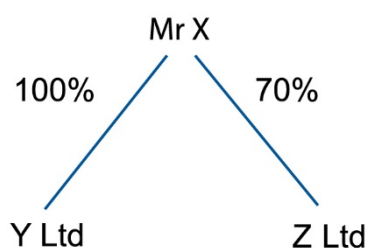
- the issued share capital of another company, **or**
- the voting power, **or**
- the right to receive distributable profits, **or**
- the right to receive the net assets in the event of a winding up.

Examples of each situation:

- One company controls the other(s).

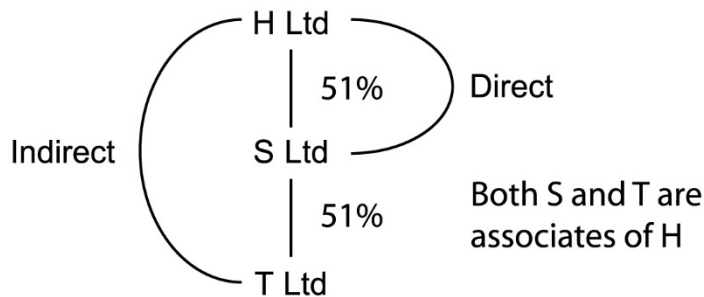


- Both are controlled by the same 'person' (company or individual).



X Ltd, Y Ltd and Z Ltd are associated. Mr X is the controlling link, although as an individual he is not included in the number of associated companies.

Note that control can be exercised directly or indirectly.



It is not necessary to have an effective interest of > 50% for associates therefore it does not matter that H Ltd's effective interest in T Ltd is only 26.01% (0.51×0.51).

The definition of associated companies specifically **includes**:

- overseas resident companies
- subsidiaries joining and leaving during the AP

but **excludes**:

- dormant companies, and
- inactive non-trading holding companies.

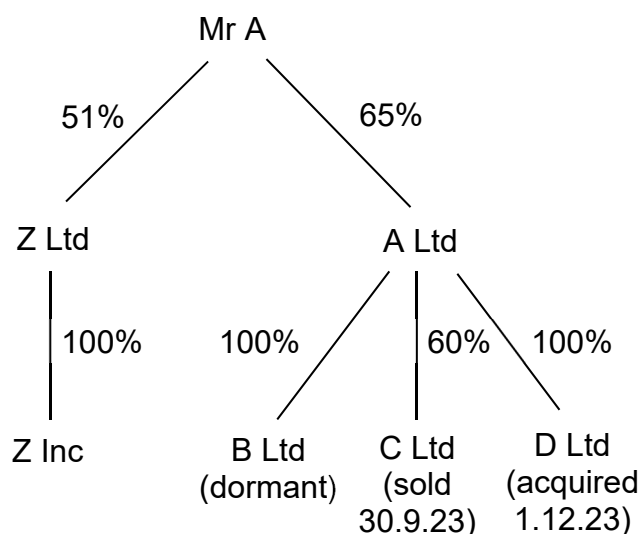
The consequences of associated companies

The consequences of having associated companies are:

- The **upper and lower limits** used to determine the appropriate rate of corporation tax to apply, are **divided by the total number of associated companies during the accounting period** (i.e. including any which were not associated for the whole of the accounting period), thereby potentially increasing the effective rate of tax each company pays.
- The £1.5 million threshold used to determine whether the company is 'large' for the purposes of paying corporation tax quarterly instalments is **divided by the total number of associated companies at the end of the previous AP** (see section 3).
- **Dividends received** from associated companies (UK and overseas) are **excluded from** the calculation of augmented profits.
- A group of companies is entitled to a single annual investment allowance (AIA) for capital allowances, but can choose how to allocate the AIA between group companies (Chapter 2).



Test your understanding 2



All companies except Z Inc are UK resident and prepare financial statements to 31 March 2024.

A Ltd has taxable total profits of £40,000 for the year ended 31 March 2024. A Ltd also receives dividends of £5,000 from D Ltd in January 2024.

- (a) **State which companies are associated companies of A Ltd for the year ended 31 March 2024.**
- (b) **Calculate the corporation tax liability of A Ltd for the year ended 31 March 2024.**

3 Payment of tax



Due date

The payment date for corporation tax depends on the size of the company:

- For companies which are not 'large':
 - due date = **nine months and one day** after the end of the AP.
- For 'large' companies:
 - the liability is settled through **quarterly instalment payments**, starting during the accounting period.

All companies must pay their corporation tax electronically.

Definition of a large company



- A large company is one whose **augmented profits** for the accounting period in question are **more than the profit threshold of £1.5 million** (but not more than £20 million).
- A company with augmented profits exceeding £20 million is a very large company, but the payment arrangements for these companies are not on the ATX syllabus.
- Companies with augmented profits of no more than £1.5 million are not large and are therefore not required to pay corporation tax by instalments.

The £1.5 million threshold

- The £1.5 million threshold may need to be adjusted in almost the same way as the upper and lower limits for corporation tax:
 - Short AP: time apportion
 - Associated companies divide by the total number of associated companies **at the end of the previous AP**



The threshold of £1.5 million is included within the tax rates and allowances provided to you in the examination.



Test your understanding 3

Beech Ltd has the following results for the nine months ended 31 March 2024.

TTP	£30,000
Dividends received from non-group companies	£2,000

Calculate the CT liability and state when it will be payable.

Quarterly instalments for large companies

Instalments paid by a large company are based on the expected corporation tax liability for the **current** accounting period. It is therefore necessary for companies to produce an accurate forecast of their current period tax liability.

Companies will normally be able to obtain a refund if they subsequently find that instalments have been overpaid.

Interest will be charged or paid (see below) based on the **actual** corporation tax due per the final tax return.

For a 12-month accounting period, four quarterly instalments are due:

- by the **14th day**
- of months **7, 10, 13 and 16** following the start of the accounting period.

Exception to instalments for large companies

Large companies which do not have to pay by instalments are as follows:

- companies whose liability for the year is below **£10,000** (or a pro rata amount if the AP is less than 12 months long)
- companies that have become large during the AP provided:
 - (i) they were not large for the previous AP, and
 - (ii) their augmented profits for the AP do not exceed **£10 million** (reduced accordingly if there are associated companies or a short AP).



Test your understanding 4

Quad plc is a single company with no associated companies.

On 1 February 2024 Quad plc estimates that its taxable total profits will be £2,400,000 for the year ended 31 October 2024. Its taxable total profits for the year ended 31 October 2023 were £1,700,000 and for the year ended 31 October 2022 £1,200,000.

Quad plc does not receive any dividends.

- (a) **Calculate Quad plc's corporation tax liabilities for the years ended 31 October 2023 and 31 October 2024 and explain how they will be paid. Assume you are writing in June 2024 and that the FY2023 rates apply throughout.**
- (b) **In July 2024 the company revises its forecast taxable total profit figure to £2,640,000. State the difference, if any, this will make to its corporation tax payments.**

Special rules apply if the accounting period is less than 12 months.



Short accounting periods for large companies

Where the accounting period is less than 12 months:

- First instalment due by:
14th day of 7th month after the start of the AP (as normal)
- Subsequent instalments are due at three monthly intervals thereafter, until the date of the last instalment (see below) is reached.
- Last instalment due by:
14th day of 4th month after the end of the accounting period.

- For an accounting period of three months or less applying the above instalment rules would result in the date of the first instalment being later than the last instalment. Therefore, in this situation the full tax due for the accounting period is due on the date of the last instalment, i.e. 14th day of 4th month after the end of the accounting period.
- The amount of each instalment:
$$= (\text{estimated CT liability for AP}) \times (n/\text{length of AP})$$

Where $n = 3$ months for a full quarterly instalment

But $n = 2$ or 1 for the last instalment if the period since the previous instalment is less than 3 months.



Illustration 7 – Quarterly instalment payments for large companies

Argon plc prepared accounts for the eight months ended 31 December 2023 and estimates its corporation liability will be £800,000.

Show when Argon plc's corporation tax liability will be due.

Solution

Argon plc's corporation tax liability is due by instalments:

£300,000 on 14 November 2023

£300,000 on 14 February 2024

£200,000 on 14 April 2024

Interest

Late payment interest:

- runs from: the normal due date on any tax paid late
- to: the date of payment, and

This interest is deducted from interest income in the corporation tax computation.

Any repayment of tax made by HMRC will attract interest:

- from the later of:
 - the day after the original due date, or
 - the actual date of payment
- to: the date of repayment.

This interest is taxable and is included in interest income in the corporation tax computation.



The interest rates will be provided in the tax rates and allowances provided in the examination.

Group payment arrangements

Group payment arrangements are **available** for **associated companies** where at least one group company pays corporation tax by quarterly instalments.

The effect is as follows:

- **One group company pays** quarterly instalments of corporation tax on behalf of the group.
- This can **save interest**, as overpayments are effectively netted off against underpayments.

Without a group payment arrangement, the interest charged on underpayments is likely to be more than the interest received on overpayments.

However, each company must still prepare a separate corporation tax computation at the end of the AP.

Impact of taxation on the cash flows of a business

Companies need to take account of their tax payments when considering their cash flow forecasts for the year.

This will be a particular problem when the company changes to quarterly instalments for the first time.

4 Self-assessment for companies



Introduction

As for individuals, self-assessment applies for corporate taxpayers. Responsibility rests with the company to:

- calculate its own corporation tax liability for each AP
- submit a self-assessment corporation tax return **within 12 months** after the end of the period of account
- pay any corporation tax due **within nine months and one day** after the end of the AP or under the quarterly instalment system.

Given the timing of the due date for payment of tax, many companies will aim to complete the self-assessment tax return prior to the normal nine month deadline for paying the corporation tax to enable them to pay an accurate amount of tax and avoid interest charges on underpaid tax.



Notification of chargeability

A company coming within the scope of corporation tax for the first time must notify HMRC when its first accounting period begins, **within three months** of the start of its first accounting period.

Companies that do not receive a notice to file a corporation tax return are required to notify HMRC if they have income or chargeable gains on which tax is due.

The time limit for notifying HMRC of chargeability is **12 months** from the end of the accounting period in which the liability arises.

A standard penalty may be imposed for failure to notify HMRC of chargeability (see section 5).



The self-assessment tax return

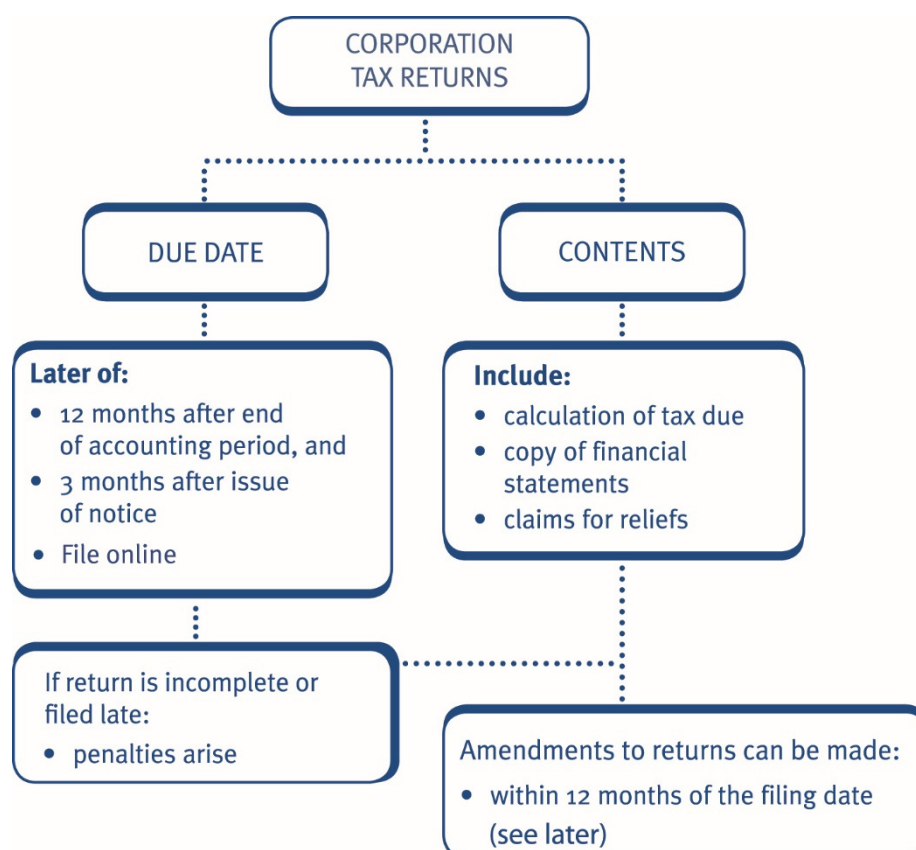
The self-assessment tax return (Form CT600) must be submitted by the later of:

- **12 months** after the end of the accounting period, or
- **three months** after the issue of the notice to file a return.

The return must:

- contain all the information required to calculate the company's taxable total profits
- include a self-assessment of the amount of corporation tax payable for that accounting period
- be submitted online.

A company has to submit a copy of its financial accounts together with the self-assessment tax return.



Determination assessments

To prevent companies deliberately delaying the submission of a return, HMRC has the following actions available if a return is not filed by the relevant due date:

- HMRC may determine the amount of corporation tax due by issuing a determination assessment.
- The determination assessment is treated as a self-assessment by the company, and will be replaced by the actual self-assessment when it is submitted by the company.
- There is no right of appeal against a determination assessment. Instead, the company must displace it with the actual self-assessment return.
- A determination assessment can be raised by HMRC at any time **within three years** of the filing date (i.e. four years from the end of the period of account).



Records

Companies are required to keep and preserve records necessary to make a correct and complete return.

The records that must be kept include records of:

- all receipts and expenses
- all goods purchased and sold
- all supporting documents relating to the transactions of the business, such as accounts, books, contracts and receipts.

The records must be retained until the later of:

- **six years** after the end of the accounting period to which they relate
- the date on which a compliance check into the return is completed
- the date on which it becomes impossible for a compliance check to be started.

A penalty may be charged for failure to keep or retain adequate records.

The maximum penalty is only likely to be imposed in the most serious cases, such as where a company deliberately destroys its records in order to obstruct a HMRC compliance check.

See section 5 for the detail of penalties that can be imposed.



Amendments and errors

Amendments to the return

- HMRC may correct any obvious errors or mistakes **within nine months of** the date that the return is filed. For example, they will correct arithmetical errors or errors of principle. This type of correction does not mean that HMRC has accepted the return as accurate.
- A company can amend the return **within 12 months** of the filing date. For an AP ending on 31 March 2024, the filing date is 31 March 2025, and the company has until 31 March 2026 to make any amendments.
- If an error is discovered at a later date, then the company can make a claim for overpayment relief to recover any overpayments of corporation tax.

Claim for overpayment relief

- Where an assessment is excessive due to an error or mistake in a return, the company can claim relief.
- A claim can be made in respect of errors made, and mistakes arising from not understanding the law.
- The claim must be made **within four years** of the accounting period to which it relates.



Compliance checks into returns

HMRC has the right to check the completeness and accuracy of any self-assessment tax return and issue discovery assessments under their compliance check powers. The procedures and rules are similar to those for individuals.

The compliance check may be made as a result of any of the following:

- suspicion that income is undeclared
- suspicion that deductions are being incorrectly claimed
- other information in HMRC's possession
- being part of a random selection process.

Additional points:

- HMRC does not have to state a reason for the compliance check and is unlikely to do so.
- HMRC must give **written notice** before commencing a compliance check by the following dates:

If return filed:	Notice must be issued within 12 months of:
On time	the actual delivery of the tax return to HMRC
Late	the 31 January, 30 April, 31 July or 31 October next following the actual date of delivery of the tax return to HMRC

- Once this deadline is passed, the company can normally consider the self-assessment for that accounting period as final.

Compliance check procedure

HMRC can demand that the company produce any or all of the following:

- documents
- accounts
- other written particulars
- full answers to specific questions.

The information requested should be limited to that connected with the return.

- The company has 30 days to comply with the request. An appeal can be made against the request.
- The compliance check ends when HMRC gives written notice that it has been completed.
- The notice will state the outcome of the compliance check and any HMRC amendments to the self-assessment.
- A company has 30 days to appeal, in writing, against HMRC's amendment.
- Refer to Chapter 15 for more details about appeal procedures.



Discovery assessments

HMRC has the capacity to raise additional assessments, referred to as discovery assessments. The key points are:

- Although compliance checks must normally begin **within 12 months** of the actual submission date, a discovery assessment can be raised at a later date to prevent the loss of corporation tax.
- The use of a discovery assessment is restricted where a self-assessment return has already been made. Unless the loss of corporation tax was brought about carelessly or deliberately by the company, a discovery assessment cannot be raised where full disclosure was made in the return, even if this is found to be incorrect.
- HMRC will only accept that full disclosure has been made if any contentious items have been clearly brought to its attention – perhaps in a covering letter.
- Therefore, only a company that makes full disclosure in the self-assessment tax return has absolute finality 12 months after the actual submission date.

- The time limit for making a discovery assessment is:

	Time from the end of the AP
Basic time limit	four years
Careless error	six years
Deliberate error	twenty years

- A company may appeal against a discovery assessment.

5 Penalties

In addition to interest on the late payment of tax, HMRC can impose penalties.

Standard penalty

HMRC has standardised penalties across the taxes for the submission of incorrect returns and failure to notify liability to tax.

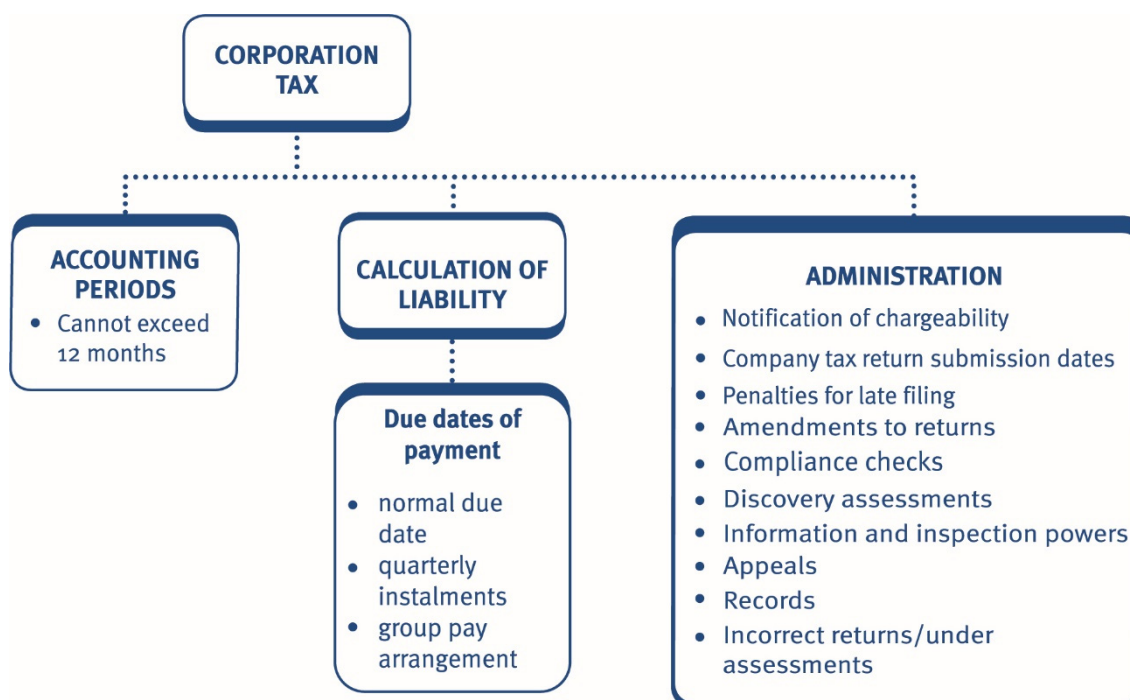
The rules are explained in Chapter 15, section 7.

The penalty is calculated as a percentage of 'potential lost revenue' which is generally the tax unpaid. The percentage charged can be reduced where the taxpayer makes a disclosure and co-operates with HMRC to establish the amount of tax unpaid.

Other penalties

Offence	Penalty
Late filing of corporation tax return: <ul style="list-style-type: none"> within three months of filing date more than three months after filing date 	<ul style="list-style-type: none"> Fixed penalty = £100 (Note) Fixed penalty increased to £200 (Note)
Additional penalties: <ul style="list-style-type: none"> 6 – 12 months after filing date More than 12 months after filing date 	<ul style="list-style-type: none"> Additional 10% of tax outstanding six months after filing date Additional penalty increased to 20% <p>Note: Fixed penalties rise to £500 and £1,000 if persistently filed late (i.e. return for two preceding periods also late)</p>
Failure to keep required records	Up to £3,000 per accounting period

6 Chapter summary



Test your understanding answers



Test your understanding 1

Flute Ltd

	£
TTP	75,000
Plus: Dividends received from non-group companies	15,000
	<hr/>
Augmented profits	90,000
	<hr/>

The AP straddles 31 March 2023.

As augmented profits are between the lower limit of £50,000 and the upper limit of £250,000, marginal relief applies.

Six months (1 October 2022 to 31 March 2023) fall into FY2022 and six months (1 April 2023 to 30 September 2023) fall into FY2023.

The corporation tax liability is calculated as follows:

	£
FY2022 ($£75,000 \times 19\% \times 6/12$)	7,125
FY2023 ($£75,000 \times 25\% \times 6/12$)	9,375
Less: Marginal relief	
$(£250,000 - £90,000) \times 3/200 \times £75,000/£90,000 \times 6/12$	(1,000)
	<hr/>
Corporation tax liability	15,500
	<hr/>



Test your understanding 2

A Ltd

(a) Associated companies

A Ltd has four associated companies: Z Ltd, Z Inc, C Ltd and D Ltd.

Mr A controls all of the companies in the diagram but is not included as an associate as he is an individual and not a company.

Z Inc is an associated company even though it is incorporated overseas.

B Ltd is excluded from being an associate as it is dormant throughout the accounting period.

C Ltd and D Ltd are associated for the whole accounting period even though they have only been part of the group for six months and four months respectively.

(b) A Ltd: Corporation tax liability – year ended 31 March 2024

	£
TTP	40,000
Plus: Dividends	
(ignore dividends from associated companies)	0
	<hr/>
Augmented profits	40,000
	<hr/>

As A Ltd has four associated companies, the limits must be divided by five companies:

Lower limit = $(£50,000 \div 5) = £10,000$

Upper limit = $(£250,000 \div 5) = £50,000$

As augmented profits are between the limits, marginal relief applies.

The corporation tax liability is calculated as follows:

	£
Corporation tax $(£40,000 \times 25\%)$	10,000
Less: Marginal relief	
$(£50,000 - £40,000) \times 3/200$	(150)
	<hr/>
Corporation tax liability	9,850
	<hr/>



Test your understanding 3

Beech Ltd

	£
TTP	30,000
Plus: Dividends received from non-group companies	2,000
	<hr/>
Augmented profits	32,000
	<hr/>

The AP all falls into FY2023.

The upper and lower limits must be scaled down as the AP is only nine months.

Lower limit ($£50,000 \times 9/12$)	£37,500
Upper limit ($£250,000 \times 9/12$)	£187,500

The small profits rate applies as augmented profits are below the lower limit.

Corporation tax on TTP ($£30,000 \times 19\%$)	£5,700
	<hr/>

The corporation tax payment threshold must also be scaled down.

Threshold ($£1,500,000 \times 9/12$)	£1,125,000
--	------------

Augmented profits fall below the threshold and therefore Beech Ltd is not large.

Due date	1 January 2025
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Test your understanding 4

Quad plc

(a) Corporation tax liabilities

Assuming that FY2023 rates apply throughout, the company will be liable to corporation tax as follows:

Y/e 31 October 2023 ($£1,700,000 \times 25\%$)	£425,000
	<hr/>
Y/e 31 October 2024 ($£2,400,000 \times 25\%$)	£600,000
	<hr/>

Payment dates

Y/e 31 October 2023

As Quad plc's augmented profit (TTP = augmented profit as no dividends received) for the y/e 31 October 2022 was less than the profits threshold of £1.5 million, the company was not large for corporation tax purposes in this AP.

Quad plc's augmented profit of £1.7 million for the y/e 31 October 2023 exceeds the profits threshold of £1.5 million, but quarterly instalment payments will not be due as the company was not large in the previous AP (y/e 31 October 2022) and its augmented profit does not exceed £10 million.

Accordingly, the liability of £425,000 for the y/e 31 October 2023 will be due on 1 August 2024 (nine months and one day after the end of the AP).

Y/e 31 October 2024

For the y/e 31 October 2024, as the augmented profits exceed the profits threshold of £1.5 million and the company was large in the previous AP, it will have to pay the £600,000 liability in quarterly instalments as follows:

Due date	£
14 May 2024	150,000
14 August 2024	150,000
14 November 2024	150,000
14 February 2025	150,000
	<hr/>
	600,000
	<hr/>

Note that interest will be charged from the due date until the date of payment for any instalments paid late (see section 3). This interest is an allowable deduction from interest income.

(b) If Quad plc revises its forecast

If the profit forecast is revised upwards the company will have to revise its forecast tax payments.

The corporation tax liability will increase to £660,000 (£2,640,000 × 25%).

Quarterly payments should therefore be £165,000 (£660,000 × 1/4).

Therefore, an extra £15,000 (£165,000 – £150,000) will be due for each instalment.

As the instalment for May has already been paid, the additional £15,000 will attract interest from 14 May 2024 until it is paid (see section 3).

Calculation of corporation tax: Income and gains

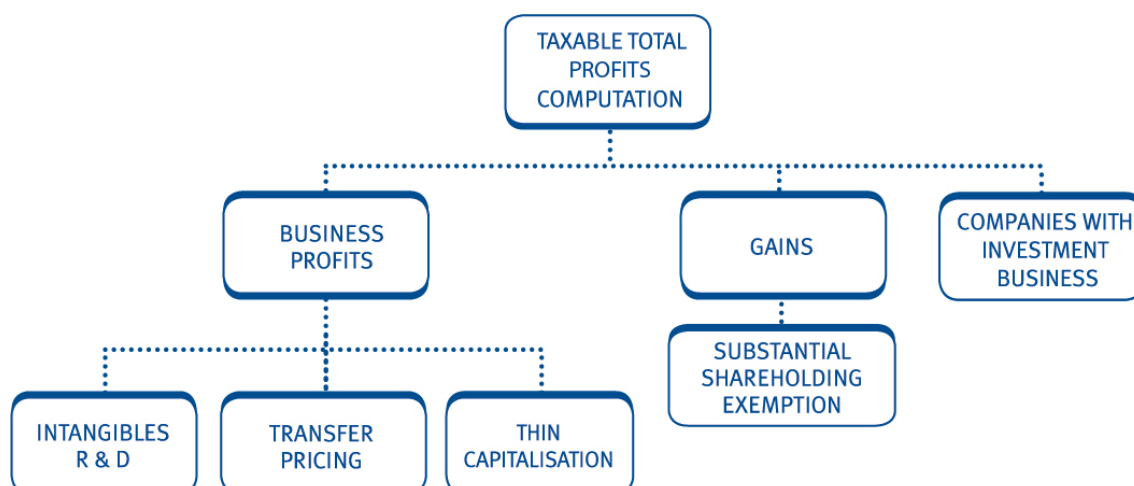
Chapter learning objectives

Upon completion of this chapter you will be able to:

- prepare a comprehensive computation of taxable total profits for a company, including distinguishing the key differences in the computation of gains
- identify and calculate corporation tax for companies with investment business
- identify qualifying research and development expenditure, both capital and revenue, and determine the reliefs available for small or medium sized enterprises (SMEs)
- recognise the alternative tax treatments of intangible assets and conclude on the best treatment for a given company
- advise on the impact of the transfer pricing and thin capitalisation rules on companies
- advise on the allocation of the annual investment allowance between group or related companies
- determine the application of the substantial shareholdings exemption.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter revises the rules for computing a company's TTP and introduces the new topic areas at ATX shown in the diagram above.



A brief reminder of TX content is given in supplementary reading and revision examples are provided to check your retention of the required TX knowledge.

1 Computation of taxable total profits

Pro forma computation

Name of company

Corporation tax computation – for AP ended:

	£
*Trading profits	X
*Interest income (non-trade loan relationships)	X
*Property income	X
Miscellaneous income	X
Net chargeable gains (chargeable gains less allowable losses)	X
	<hr/>
Total profits	X
Less: Qualifying charitable donations (QCDs) (amount paid = gross amount)	(X)
	<hr/>
Taxable total profits (TTP)	X
	<hr/>

* Including overseas income (gross of overseas tax suffered).

Trading profits

As for a sole trader, the net profit per the accounts must be adjusted for tax purposes and capital allowances deducted. Trading profits are always dealt with on an accruals basis for companies.

The main adjustments are summarised in Chapter 21.

The key differences that apply to adjusting a company's profits are:

- There are no private use adjustments (including the capital allowances computation).
- Any interest receivable or payable for trading reasons is included in trading profit.
- If the interest is receivable or payable for a non-trading purpose then it is included in interest income (see below).
- Dividends payable are not an allowable trading expense.
- Enhanced deductions are available for research and development expenditure if conditions are satisfied (section 3).
- Adjustments may be required in respect of intangible assets (section 4), transfer pricing (section 6) and thin capitalisation (section 6).

Capital allowances

Capital allowances apply to companies in the same way as unincorporated businesses with the following additional points to note:

Annual investment allowance

- The maximum AIA for a 12 month accounting period is £1,000,000 (the same as for an unincorporated business (e.g. sole trader or partnership)).



The AIA amount of £1,000,000 is included in the tax rates and allowances provided to you in the examination.



- The AIA must be **split between 'related companies'**.

A **group of companies** (i.e. parent company and subsidiaries) are 'related' for this purpose and the group is only entitled to **one AIA**.

The group can choose how to allocate a **single AIA** between the group companies.

Note that:

- A 'group' for this purpose is defined by the Companies Act and essentially applies where a parent company holds a simple majority shareholding (> 50%) in another company or companies at the end of the accounting period.
- Therefore in an examination question related to capital allowances for a company within a group, the allocation of the AIA between the group members will need to be considered.

When allocating the AIA:

- the group members can allocate the maximum £1,000,000 AIA in any way across the group
- the AIA does not have to be divided equally between them
- all of the allowance can be given to one company, or any amount can be given to any number of companies within the group.

Companies owned by the **same individual** will also be regarded as 'related' for this purpose where they are:

- engaged in the **same activities**, or
- share the **same premises**.

For example, this could be the case if an individual runs two companies from home.

In such circumstances, the AIA will be split between the two companies and the owner of the companies can choose how to allocate a **single AIA** between them.

- **Unrelated companies** owned by the same individual will each be entitled to the **full AIA**.

Enhanced capital allowances (ECAs)

Companies purchasing new qualifying plant and machinery between 1 April 2021 and 31 March 2023 were eligible to claim:

- 130% super deduction for assets which would ordinarily go into the main pool, or
- 50% first year allowance (FYA) for special rate pool assets.

For special rate pool assets, the AIA would have been claimed in preference to the 50% FYA, with the 50% FYA applied to the balance (if any) of the expenditure.



A question **will not be set** in the exam involving an initial claim for enhanced capital allowances, but you may be required to deal with the disposal of plant and machinery on which enhanced capital allowances were claimed.

Disposal of assets on which ECAs were claimed

- Disposals of assets that qualified for the 130% super deduction will trigger an immediate balancing charge equal to the disposal proceeds.
 - Disposals of assets that qualified for the 50% FYA will trigger an immediate balancing charge calculated as:
 - $\text{proceeds} \times \text{proportion of expenditure on which FYA claimed} \times 50\%$.
- The remaining proceeds are deducted from the balance on the special rate pool before the 6% WDA is calculated.



Illustration 1 – Disposals of assets on which ECAs were claimed

Spritz Ltd has an accounting reference date of 31 March.

During the year ended 31 March 2024 Spritz Ltd sold the following assets:

- Machinery for proceeds of £70,000. This cost £90,000, on which the 130% super deduction was claimed.
- Integral features for proceeds of £750,000. The original cost of these was £1,200,000, on which AIA of £1,000,000 was claimed and 50% FYA on the balance.

As at 1 April 2023 the tax written down value on the main pool was £450,000 and on the special rate pool was £1,700,000.

Calculate the maximum capital allowances Spritz Ltd can claim for the year ended 31 March 2024.

Solution

Capital allowances – y/e 31 March 2024

	Main pool	Special rate pool	Allowances
	£	£	£
TWDV b/f	450,000	1,700,000	
Disposals			
Super deduction:			(70,000)
balancing charge			
Proceeds relating to 50% FYA:			
balancing charge (Note)			(62,500)
Balance of proceeds			
(£750,000 – £62,500)		(687,500)	
	450,000	1,012,500	
WDA @ 18%/6%	(81,000)	(60,750)	141,750
	369,000	951,750	
TWDV c/f			
Total allowances			9,250

Note: The AIA was claimed on the first £1,000,000 of the cost of the integral features and the 50% FYA was claimed on the balance of £200,000 (£1,200,000 – £1,000,000).

A balancing charge arises on the sale proceeds relating to the proportion on which the FYA was claimed:

$$(\text{£}750,000 \times \text{£}200,000 / \text{£}1,200,000 \times 50\%) = \text{£}62,500$$

The balance of the proceeds is deducted from the special rate pool.

Pro forma capital allowances computation – companies

The following pro forma should be used if a full capital allowances computation is required:

	AIA £	FYA £	Main pool £	Special rate pool £	Short life asset £	Allowances £
TWDDV b/f			X	X	X	
Additions:						
Not qualifying for AIA:						
Cars (1 – 50g/km)			X			
Cars (over 50g/km)				X		
Qualifying for AIA:						
Special rate pool expenditure	X					
AIA (Max £1,000,000 in total)	(X)					X
	—					
				X		
Main pool expenditure	X					
AIA (Max £1,000,000 in total)	(X)					X
	—					
			X			
Disposals						
(lower of original cost and sale proceeds)			(X)	(X)	(X)	
BC on assets qualifying for super deduction						(X)
BC on proceeds relating to 50% FYA						(X)
Balance of proceeds relating to 50% FYA				(X)		
			—	—	—	
			X	X	X	
BA/(BC)					X/(X)	X/(X)
					—	
Small pools WDA (if applicable)						
WDA @ 18%			(X)			X
WDA @ 6%				(X)		X
Additions qualifying for FYAs:						
Zero emissions cars		X				
FYA @ 100%		(X)				X
		—				
			0			
		—	—	—		
TWDDV c/f	0		X	X		
	—		—	—		
Total allowances						X
						—

Structures and buildings allowances (SBAs)

Where a business incurs expenditure on **qualifying costs** for **new non-residential** structures and buildings, or renovations or extensions to existing buildings on or after 29 October 2018, it is eligible for SBAs.

In the examination, questions will only be set where the building was constructed or renovated on or after 6 April 2020 (1 April 2020 for limited companies) and where relevant the construction date will be given.

Where buildings are **purchased** (as opposed to newly constructed), it should be assumed that SBAs are **not available** unless stated otherwise.

The building or structure must be used for a **trade or property letting business**, but residential properties (dwelling houses) do not qualify.

Qualifying costs include:

- buildings including offices, retail and wholesale premises, factories, warehouses, hotels and care homes
- structures including roads, walls, bridges and tunnels.

Qualifying costs do **not** include land, legal fees, stamp duty land tax or repairs and maintenance.

SBAs available

- SBA = an annual straight line allowance of 3% on qualifying costs
- from the date the building or structure is brought into qualifying use (time apportion if part way through a period).



The SBA amount of 3% is included in the tax rates and allowances provided to you in the examination.

There is no pooling system for assets eligible for SBA so they are kept separate from other assets which qualify for capital allowances.

Any asset eligible for SBA will not be eligible for AIA.

Disposal

When an asset is sold:

- The seller claims SBA to the date of disposal (time apportion if part way through a period).
- There is no balancing adjustment for the seller.
- The SBAs claimed to date must be added to sale proceeds for the calculation of the chargeable gain or loss arising for the seller.
- The buyer takes over the remainder of the useful life and receives a 3% SBA based on the original cost of the structure or building.



Test your understanding 1

On 1 May 2023 Peacock plc entered into a contract to construct a new head office. Construction was completed on 31 October 2023 and the head office was used from 1 December 2023.

The costs incurred were as follows:

	£
Land	200,000
Stamp duty land tax	1,000
Legal fees	10,000
Construction costs	450,000
Plant and machinery (all new)	100,000

Peacock plc retains the plant and machinery but sells the head office to Flamingo Ltd for £1,000,000 (including £250,000 for the land) on 1 April 2025. Flamingo Ltd immediately starts using the head office in its trade.

Both Peacock plc and Flamingo Ltd prepare accounts to 31 December each year.

- Calculate the capital allowances available to Peacock plc for the year ended 31 December 2023 in respect of the head office.**
- Explain the SBA implications on the sale of the head office to Flamingo Ltd on 1 April 2025.**

Interest income – loan relationship rules

All income and expenses related to the borrowing and lending of money are dealt with under the loan relationship rules.

Expenses related to borrowing money

- interest paid on overdrafts, bank loans, corporate loan notes
- other costs such as arrangement fees, and other incidental costs incurred in raising loan finance
- write-off of impaired debt arising from lending money
- loss on disposal of corporate loan notes

Income received from lending money

- interest income (including interest from bank deposits, loans, government stocks and corporate loan notes)

Trade vs. non-trade purposes

In order to apply the loan relationship rules correctly, all income and expenses relating to borrowing and lending must be identified as either 'trading' or 'non-trading'.

	Income (e.g. interest receivable)	Expenses (e.g. interest payable)
Trade purpose	N/A (note 1)	<ul style="list-style-type: none"> • interest payable/expenses related to: <ul style="list-style-type: none"> – a loan taken out to purchase plant and machinery for the trade – a loan taken out to purchase property used for trading purposes e.g. office, warehouse – a loan or overdraft to fund daily operations (i.e. working capital) – loan notes to fund trading operations • write-off of a trade related loan
Non-trade purpose	<ul style="list-style-type: none"> • interest receivable on bank accounts • interest receivable on investments such as gilts and loan notes • interest receivable from HMRC (note 2) • profit on disposal of corporate loan notes (note 3) 	<ul style="list-style-type: none"> • interest payable/expenses related to: <ul style="list-style-type: none"> – a loan to purchase a commercially-let property (where the rent would be taxable as property income) – a loan to acquire shares of another company • interest payable to HMRC (note 2) • write off of a non-trade loan • loss on disposal of corporate loan notes (note 3)

Notes:

- (1) Generally, all interest received by a company is non-trade interest, unless it is a company's trade to lend money (e.g. a bank, which is not likely to be the case in the examination) or it is interest charged on late paid customer invoices.
- (2) Interest received from HMRC by a company is taxable as interest income. Interest paid to HMRC by a company is an allowable deduction from interest income.

Note that for individuals (e.g. sole traders), interest received from HMRC is exempt income and interest paid to HMRC is not deductible for income tax purposes.

- (3) Note that a disposal of loan notes is not an exempt disposal for companies, unlike for individuals where the sale of a qualifying corporate bond (QCB) is exempt from capital gains tax.

Tax treatment – trade purpose

Amounts that are for trade purposes will be included as part of trading profits in the calculation of TTP.

If such amounts are already included in the accounting profit, no adjustment to profits is required for tax purposes.

Tax treatment – non-trade purpose

Amounts that are for non-trade purposes will be included under the 'Interest income (non-trade loan relationships)' heading in the calculation of TTP.

If these amounts are included in the accounting profit, they must be added back/deducted in the adjustment of profits computation and then shown separately under the 'Interest income (non-trade loan relationships)' heading.

Interest received and receivable is usually credited in the company accounts on the accruals basis. As interest receivable by companies is taxed on the accruals basis, the figure included in the accounts is the figure that should be taxed as interest income.

Generally, companies receive interest **gross** and the amount credited in the accounts is stated gross.

Most interest paid by companies is paid gross and interest paid and payable is usually debited in the company accounts on the accruals basis. As interest payable is taxed on the accruals basis, the figure included in the accounts is the figure that should be deducted in the calculation of interest income.

The **exception** to this rule is interest paid **to an individual on unquoted loan notes**, where a company is required to deduct 20% income tax from any interest paid to an individual. The company must account to HMRC for the income tax it deducts at source on behalf of the individual on a quarterly basis.

However, note that in the accounts of the company, the interest paid and payable charged against profit in the accounts will be the gross amount whether or not it is paid to another company or an individual.

If the non-trade expenses are more than the non-trade income, the excess is a deficit eligible for loss relief (Chapter 3).



Overseas income

- Any income from overseas (such as interest or rents) must be included in TTP under the appropriate heading.

Dividends from overseas should be excluded as all dividends received by a company are exempt from corporation tax for the purposes of the ATX exam.

- Profits from overseas branches are included in trading profits unless the exemption election is made (Chapter 5).
- Overseas tax deducted must be added back to include the gross income in taxable total profits.
- Double tax relief may be available (Chapter 5).

Property income

Property income is calculated in the same way as for individuals (Chapter 18) except:

- a company is **always** taxed on the accruals basis
- a company is assessed on income arising in the accounting period, not the tax year
- interest on a loan to buy let property is treated as a deduction from interest income under the loan relationship rules, not property income
- there is no restriction on the interest deduction if a company borrows to invest in residential property
- losses can be relieved against other profits, not just property income (Chapter 3)
- companies cannot have rent-a-room relief nor furnished holiday accommodation.

Note that the replacement furniture relief is unlikely to be applicable in a corporate question in an examination. This is because the relief only applies to furnished residential properties and companies in the examination usually rent commercial properties (e.g. warehouses, offices and factories).

Miscellaneous income

Miscellaneous income is uncommon. The most likely items are as follows:

- Royalties received/paid for a non-trading purpose (e.g. held as investments).
If for a trade purpose then the amounts are included in trade profits.
In both cases the amounts are included on the accruals basis.
- Profits on the sale of goodwill and other intangible assets are included in miscellaneous income if (unusually) the asset is not held for trading purposes (section 4).

Chargeable gains

Chargeable gains are calculated in the same way as for individuals, with the following key differences:

- indexation allowance
- rollover relief
- capital losses
- annual exempt amount
- shares and securities.

These important differences are covered in more detail in section 2.

Qualifying charitable donations (QCDs)

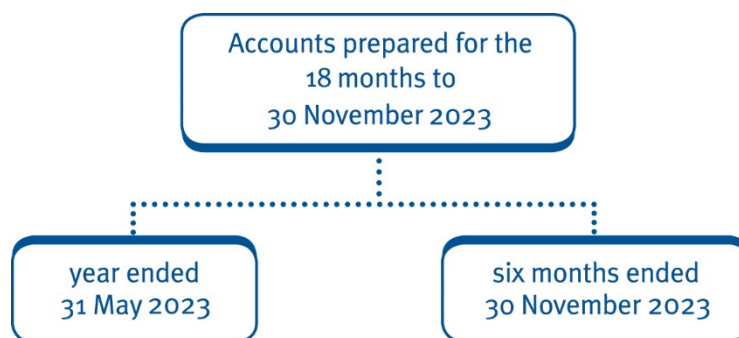
- All donations to charity by companies are allowable:
 - if a small local donation, as a trading expense
 - all other donations, as an allowable deduction from total profits.
- All charitable donations made by companies are **paid gross**.
- The amount **paid** in the accounting period is therefore allowable.
- If the QCDs paid exceed the total profits of the company:
 - no relief for the excess is given (i.e. it cannot be carried forward or carried back)
 - unless the company is part of a 75% group, in which case, group relief may be available (see Chapter 4).

Long period of account

A company requires permission from the Registrar of Companies if it wishes to extend its period of account beyond 12 months.

The period of account cannot be more than 18 months long (unless the company is in administration).

- An accounting period (AP) for corporation tax purposes can never exceed 12 months.
- Therefore, if a company prepares accounts for a period which exceeds 12 months, the period must be split into two APs:
 - one for the first 12 months, the other for the balance of the time.



- Profits are split between the accounting periods as follows:

Income	Method of allocation
Tax adjusted trading profit before capital allowances	Adjust profit for the long period of account in the normal way then time apportion
Capital allowances	Separate computations for each AP (In the short AP, the WDA and AIA is reduced accordingly)
Interest and property income	Calculate accrued amount for each period separately (Note)
Chargeable gains	According to date of disposal
Qualifying charitable donations (QCDs)	According to date paid

Note: If information to apply the strict basis is not available: time apportion.

- Two separate corporation tax computations are then prepared, with two separate payment dates.

2 Chargeable gains for companies

Chargeable gains are calculated in the same way as for individuals, with the following key differences:

Indexation allowance

- An indexation allowance (IA) is available to companies for assets acquired prior to December 2017.
The IA gives a company some allowance for the effects of inflation in calculating a chargeable gain.
- The rules for the IA are as follows:
 - the IA is calculated as:
cost of the asset × indexation factor
 - the Indexation factor is the movement in the retail price index (RPI)
 - **from** the month of purchase
 - **to** the month of disposal (or December 2017 if earlier)
 - the IA is calculated separately for each item of expenditure (e.g. calculate a different IA for the original acquisition cost and any subsequent enhancement expenditure because they have different purchase dates).
 - the IA cannot create or increase a capital loss.



Note that the indexation factor will be provided in the ATX examination.

Rollover relief

Rollover relief is the only capital gains relief available for companies.

- Relief can be claimed for:
 - gains on disposals of qualifying business assets (QBAs):
 - land and buildings used in the trade
 - **fixed** plant and machinery
 - where proceeds are reinvested in new QBAs
 - within the time period:
 - **12 months before** disposal to **3 years after** disposal.

The rules work in the same way as for individuals (see Chapter 9) with the exception of the following:

- for companies, goodwill is not a qualifying asset for rollover relief purposes
- rollover relief is applied to the gain after deducting the IA.

If all of the net proceeds from the sale of the original asset are reinvested then the whole gain may be deferred.

If only part of the net proceeds are reinvested then only some of the gain may be deferred. A gain must be left chargeable equal to the lower of:

- the gain
- the proceeds not reinvested

Any gain that is deferred is deducted from the cost of the new QBA, unless the new QBA is a depreciating asset (see Chapter 9).

The time limit for claiming the relief is four years from the later of the end of the AP in which the asset is:

- sold, or
- replaced.



Test your understanding 2

Stella Ltd has a 31 December accounting reference date. On 12 September 2023 Stella Ltd sold an office building for £3,500,000. The company had acquired the building on 3 June 1999 for £700,000 and an extension was built on 13 October 2005, costing £200,000.

The company reinvested £1,400,000 of the sale proceeds on 14 December 2023, purchasing a smaller office building for the purposes of its trade.

Assume the relevant indexation factors are as follows:

June 1999 to December 2017	0.679
October 2005 to December 2017	0.439

Calculate the chargeable gain to include in Stella Ltd's corporation tax computation for year ended 31 December 2023.

Capital losses

- All capital losses must be netted off against chargeable gains arising in the same AP.
 - any net gain is chargeable as part of TTP
 - net capital losses are carried forward against the first available future net gains (subject to possible restriction – see Chapter 3)
 - capital losses cannot be offset against other types of income, nor can they be carried back and set off against income or gains of a prior AP.
- The following steps should be carried out to compute the chargeable gains to be included in a company's corporation tax computation:
 - (1) Calculate the chargeable gains/capital loss arising on the disposal of each chargeable asset separately
 - (2) Calculate the total net chargeable gains arising in the accounting period = (chargeable gains less capital losses)
 - (3) Deduct capital losses brought forward = total net chargeable gains
 - (4) Include in TTP computation.

Annual exempt amount

- Note that there is **no AEA** available to companies, the total net chargeable gain is simply included in the company's TTP computation.

Shares and securities

- Disposals of shares should be matched as follows:
 - (1) Acquisitions on the **same day** as the disposal
 - (2) Acquisitions during the **nine days before** the disposal (**FIFO basis**)
 - (3) Acquisitions in the share pool.
- The share pool for companies is prepared as follows:
 - the pool contains shares in the same company, of the same class, purchased up to nine days before the date of disposal.
 - the pool keeps a record of the:
 - number of shares acquired and sold
 - cost of the shares, and
 - indexed cost of the shares (i.e. cost plus IA).
 - When shares are disposed of out of the share pool, the appropriate proportion of the cost and indexed cost which relates to the shares disposed of is calculated on an average cost basis.



The calculation of cost and indexed cost in the share pool is not examinable.

- The matching rules and share pool are different for individuals (Chapter 8).



Illustration 2 – Shares

Tarn Ltd sold 5,000 shares in Mound Ltd for £50,000 on 12 January 2024. They had been acquired as follows:

Share pool	3,900 shares costing	£6,638
4 January 2024	2,000 shares costing	£4,500

The indexed cost of the share pool at 12 January 2024 is £9,345.

Calculate the chargeable gain to include in the corporation tax computation.

Solution

	Shares
(1) Same day acquisitions	0
(2) Previous nine days: 4 January 2024	2,000
(3) Share pool	3,000
	<hr/>
	5,000
	<hr/>

Gain on shares acquired in last nine days:	£
Proceeds (2,000/5,000 × £50,000)	20,000
Less: Cost	(4,500)
	<hr/>
Chargeable gain	15,500
	<hr/>

Gain on shares in share pool:	£
Proceeds (3,000/5,000 × £50,000)	30,000
Less: Cost (W)	(5,106)
Less: Indexation allowance (£7,188 – £5,106) (W)	(2,082)
	<hr/>
Chargeable gain	22,812
	<hr/>

Total chargeable gains on sale of 5,000 shares in Mound Ltd:

	£
Previous nine days	15,500
Share pool	22,812
	<hr/>
Total chargeable gains	38,312
	<hr/>

Working: Share pool

	Number	Cost £	Indexed cost £
Pool per question	3,900	6,638	9,345
Sales: January 2024 (3,000/3,900)	(3,000)	(5,106)	(7,188)
	<hr/>	<hr/>	<hr/>
Balance in share pool	900	1,532	2,157
	<hr/>	<hr/>	<hr/>

- Remember that rollover relief is not available for gains on the disposal of shares.
- An exemption applies to the disposal of shares by a company out of a substantial shareholding (see below).

The conditions for the exemption often apply to disposals of shares by a company in the ATX exam such that it is usually not necessary to calculate a gain.

**Substantial shareholding exemption**

On the disposal by a company of shares **out of a substantial shareholding** in another company:

- gains = exempt**
- losses = not allowable.**



A substantial shareholding is defined as a holding:

- of $\geq 10\%$**
- owned for at least 12 months in the six years before the disposal.**

The **company disposed of** must be a **trading company** or the holding company of a **trading group** or sub group during the 12-month period and through to the date of disposal.

Note that the company disposed of does not generally have to be a trading company immediately **after** the disposal.

- The effect of this rule is to enable part disposals out of a substantial shareholding to continue to qualify for relief for five more years after the vendor's holding falls below 10%.
- In deciding whether a substantial shareholding is held, shareholdings held by other group members (which includes > 50% group companies) are taken into account.
- Where there has been a qualifying share-for-share exchange, the holding period of the original shares is effectively amalgamated with the holding period of the replacement shares in determining whether the '12 month' rule has been satisfied.

Shares owned for less than 12 months out of the previous six years

Where shares have been owned for less than 12 months, the ownership condition will still be satisfied if:

- the shares being disposed of are in a new company, and
- the new company received assets from another 75% group company, and
- the assets transferred were held and used in the trade of another group company for the 12 months before the transfer.

This is particularly important when considering corporate reconstructions and reorganisations (Chapter 4).



Test your understanding 3

Omega Ltd bought 15% of the shares issued by Epsilon Ltd, a shareholding qualifying for the substantial shareholding exemption (SSE). The shares were acquired on 1 January 2016.

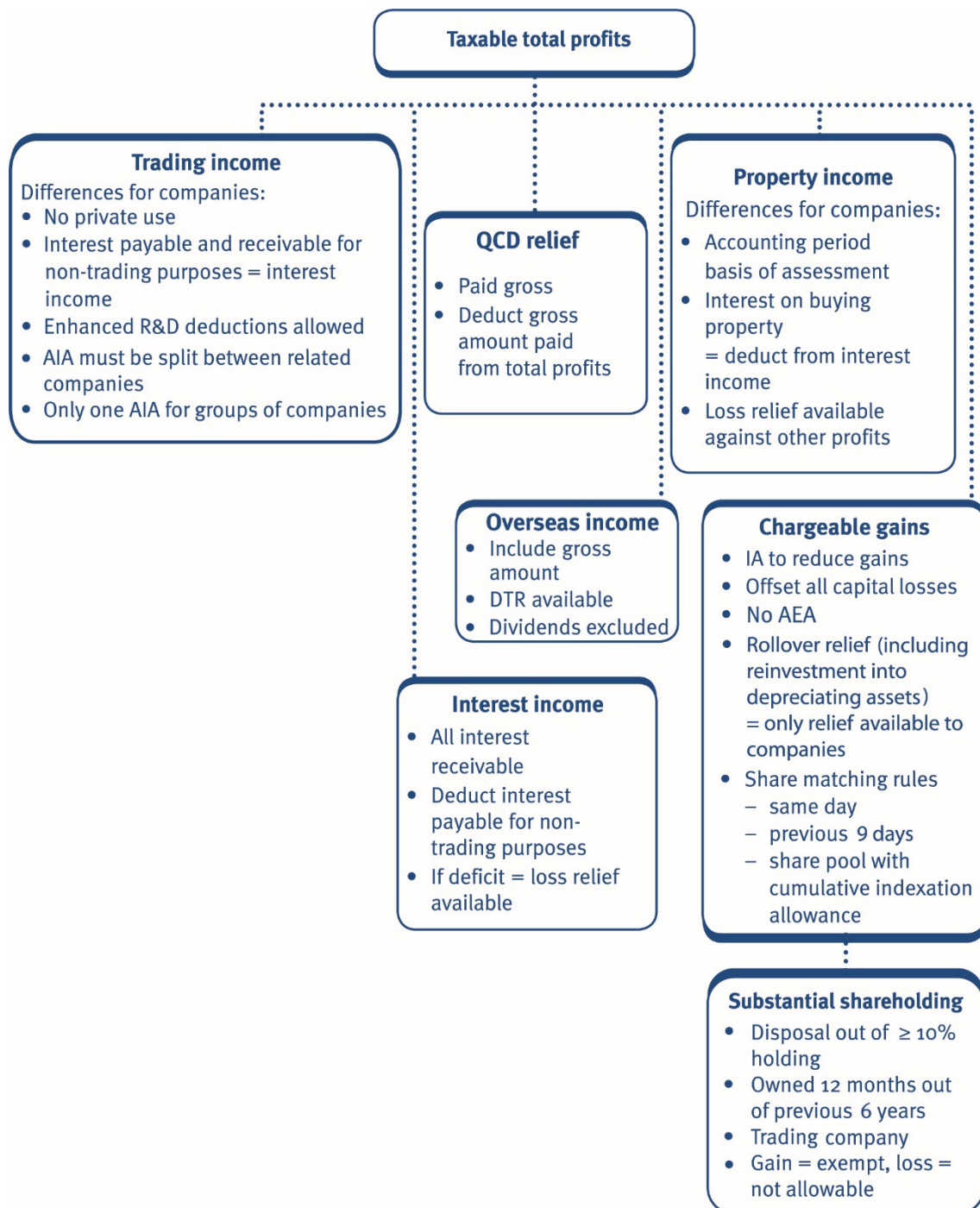
On 30 June 2019 Omega Ltd disposed of a 10% holding in Epsilon Ltd. The remaining 5% holding was disposed of on 31 December 2023.

For each disposal, explain whether the SSE applies.

Summary of key differences between individuals and companies

	Individuals	Companies
Gains subject to	Capital gains tax – tax separately from income	Corporation tax – include in TTP – tax with income
Annual exempt amount (AEA)	✓	✗
Indexation allowance	✗	✓
Matching rules for shares	Shares purchased: (1) on the same day (2) in the following 30 days (FIFO) (3) in the share pool	Shares purchased: (1) on the same day (2) in the previous nine days (FIFO) (3) in the share pool
Gain/(loss) on shares	Chargeable/(allowable) regardless of size of holding	Exempt/(ignore) if disposal out of a substantial shareholding
Treatment of capital losses	<ul style="list-style-type: none"> • Offset against current year gains without restriction • Carry forward against future net gains after deduction of AEA 	<ul style="list-style-type: none"> • Offset against current year gains without restriction • Carry forward against future net gains (subject to possible restriction – see Chapter 3)
Business asset disposal relief, gift holdover relief, PRR and investors' relief	✓	✗
Rollover relief	✓	✓ (but not on goodwill)

Summary – Taxable total profits



Comprehensive examples



Illustration 3 – Comprehensive example

Plaque Ltd is a UK resident manufacturing company with one associated company. Its statement of profit or loss for the accounting year ended 30 September 2023 shows a net profit before taxation of £331,700, after deducting the following expenses and including the following income:

Expenditure	£	
Loan note interest	12,000	Note 1
Long-term loan interest	6,000	Note 2
Depreciation	11,000	
Qualifying charitable donations made 1 August 2023	5,000	
Income		
Loan interest	8,000	Note 3
Rents accrued	7,000	Note 4
Insurance recovery	6,800	Note 5
Profit on disposal of old headquarters building	100,000	Note 6
Dividend received from non-group company	10,000	

Notes:

- (1) This represents interest on loan notes issued by Plaque Ltd in 2011 to provide funds to build a factory extension. The figure of £12,000 includes accrued interest of £3,000.
- (2) This represents interest paid on a ten-year loan raised by Plaque Ltd to purchase property which is currently let to another company.
- (3) The loan interest receivable is in respect of a loan made by Plaque Ltd to a supplier.
- (4) The rents receivable relates to the property let by Plaque Ltd.
- (5) This represents an amount recovered from the company's insurers in respect of goods destroyed in a fire last year. The cost of these goods was written off and allowed as an expense last year.
- (6) On 14 July 2023 the company sold an old building for £494,800. The building had been purchased in June 1995 for £150,000. At the time of its disposal, the building was held in the financial statements at a value of £394,800 due to a revaluation in 2019.
- (7) Capital allowances of £34,700 are available.
- (8) The indexation factor for June 1995 to December 2017 is 0.856.
- (a) **Compute the tax adjusted trading profit stating clearly your treatment of any interest paid or received.**

- (b) **Compute the corporation tax liability of Plaque Ltd for the year ended 30 September 2023.**

Solution

- (a) **Tax adjusted trading profits – y/e 30 September 2023**

	£
Profit before tax	331,700
Add: Loan note interest payable	6,000
Depreciation	11,000
QCD payments	5,000
	<hr/>
	353,700
Less: Rents receivable	(7,000)
Profit on disposal of building	(100,000)
Dividend	(10,000)
Loan interest receivable	(8,000)
Capital allowances	(34,700)
	<hr/>
Adjusted trading profits	194,000
	<hr/>

- (b) **Corporation tax computation – y/e 30 September 2023**

	£
Tax adjusted trading profits (above)	194,000
Interest income (£8,000 – £6,000)	2,000
Property income	7,000
Chargeable gain (W1)	216,400
	<hr/>
	419,400
Less: QCDs	(5,000)
	<hr/>
TTP	414,400
	<hr/>
Corporation tax	
FY2022 (£414,400 × 19% × 6/12)(W2)	39,368
FY2023 (£414,400 × 25% × 6/12)	51,800
	<hr/>
Corporation tax liability	91,168
	<hr/>

Workings**(W1) Chargeable gain on headquarters building**

	£
Proceeds	494,800
Less: Cost	(150,000)
	<hr/>
Unindexed gain	344,800
Less: IA from June 1995 to December 2017	
$0.856 \times £150,000$	(128,400)
	<hr/>
Chargeable gain	216,400
	<hr/>

(W2) Rate of corporation tax

	£
TTP	414,400
Plus: Dividend received	10,000
	<hr/>
Augmented profits	424,400
	<hr/>
Lower limit ($£50,000 \times 1/2$)	25,000
Upper limit ($£250,000 \times 1/2$)	125,000

Augmented profits are above the upper limit so the main rate applies.

As the AP straddles 31 March 2023 the corporation tax computation must be split.

**Test your understanding 4**

Arable Ltd is a manufacturer of farm equipment and prepared accounts for the nine-month period ended 31 December 2023. The following information is available:

Trading profit

The tax adjusted trading profit is £345,206. This figure is before taking account of capital allowances and any deduction arising from the premiums paid in respect of leasehold property.

Plant and machinery

Arable Ltd purchased the following assets, all of which were new, in respect of the nine-month period ended 31 December 2023.

		£
15 April 2023	Machinery	79,380
18 April 2023	Building alterations necessary for the installation of the machinery	3,700
20 April 2023	Lorry	42,000
12 June 2023	Car (1) (emissions 45g/km)	11,200
14 June 2023	Car (2) (emissions 75g/km)	14,600
17 June 2023	Car (3) (emissions 0g/km)	13,000
29 October 2023	Computer	4,400

The company will not make any short life asset elections. The tax written down values of all pools at 1 April 2023 were £Nil.

Leasehold property

On 1 April 2023 Arable Ltd acquired a leasehold office building. A premium of £75,000 was paid for the grant of a 15 year lease.

The office building was used for business purposes by Arable Ltd throughout the period ended 31 December 2023.

Arable Ltd decided to let out an old warehouse. On 30 September 2023 Arable Ltd received a premium of £50,000 for the grant of a five-year lease, and annual rent of £14,800 which was payable in advance.

Loan interest received

Loan interest of £6,000 was received on 30 September 2023, and £3,000 was accrued at 31 December 2023. The loan was made for non-trading purposes.

Dividends received

During the period ended 31 December 2023 Arable Ltd received dividends of £20,000 from Ranch plc, an unconnected company.

Profit on disposal of shares

On 5 December 2023 Arable Ltd sold 10,000 £1 ordinary shares in Ranch plc for £37,574. Arable Ltd had a share pool containing 20,000 shares in Ranch plc, with a total cost of £23,250. The indexed cost of the share pool at 5 December 2023 was £23,490. Arable Ltd's shareholding never represented more than a 1% interest in Ranch plc.

- Calculate Arable Ltd's corporation tax liability for the nine-month period ended 31 December 2023.**
- State the date by which Arable Ltd's self-assessment corporation tax return for the period ended 31 December 2023 should be submitted, and explain how the company can correct the return if it is subsequently found to contain an error or mistake.**



3 Research and development expenditure

In order to encourage more spending on research and development (R&D), additional tax reliefs are given for qualifying revenue expenditure incurred by companies.

There are separate schemes for small or medium sized enterprises (SMEs) and large companies, but only the SME scheme will be tested in the ATX exam.



You do not need to know the definition of an SME for R&D purposes.

Scheme for SMEs



The scheme works as follows:

- Enhanced relief is available if the company spends money on qualifying R&D, as defined by generally accepted accounting principles (GAAP) and guidelines from the Department for Business, Energy and Industrial Strategy.
- SMEs can deduct an **additional 86%** of qualifying expenditure for tax purposes.
- If the deduction creates a loss it may be surrendered in return for a cash payment from HMRC = 10% of the surrendered amount.
- The surrendered amount is the lower of:
 - unrelieved trading loss (after a deemed current year claim and any actual carry back and group relief claims)
 - 186% of qualifying R&D expenditure
- If surrendered in return for cash, the loss cannot also be carried forward for future relief.
- The government has introduced a cap on the amount that a loss making SME can claim in R&D tax credits. This cap is not examinable.

Qualifying R&D expenditure must be revenue expenditure on a project that seeks to achieve an advance in science or technology that is relevant to the company's trade.

It can include expenditure on the following:

- staffing costs for staff directly involved in the R&D work, including NICs (class 1 employer) and pension contributions but excluding taxable benefits
- agency staff for R&D
- materials, water, fuel and power for R&D
- software directly used in R&D
- payments to subcontractors (see below).

It cannot include:

- contributions to other bodies for independent research
- rent
- expenditure covered by a grant or subsidy.

Payments to subcontractors

Where payments are made to unconnected subcontractors, only 65% of the expenditure will qualify for enhanced tax relief.

If R&D is subcontracted to a connected company then R&D tax relief can be claimed on the lower of:

- the payment made to the subcontractor, and
- the relevant expenditure of the subcontractor.

Two companies will be classed as connected subcontractors if either:

- both companies are controlled by the same person, or
- one company controls the other.

It is possible for the company and the subcontractor to jointly elect to be treated as connected, even if they are not. This election would apply to all payments made under the same contract. The claim must be made in writing and be made within two years of the end of the engaging company's accounting period in which the contract is made.



Test your understanding 5

Dax plc is a profitable company manufacturing audio visual equipment. Dax plc is a small enterprise for the purposes of R&D.

The company has recently decided to investigate the market for a new type of classroom projection equipment and has spent the following amounts in the year ended 31 December 2023 on the project:

	£
Market research	8,000
Staff directly involved in researching the project	20,000
Administrative support for the R&D department	5,000
Heat and light in the R&D department	9,000
New software	4,000
An agency for temporary R&D staff	10,000

Advise the company of any tax relief available in respect of its expenditure.

Capital expenditure on research and development

Capital expenditure on R&D (excluding land) qualifies for a 100% R&D capital allowance in the year of purchase, so it is fully deductible as a trading expense.

It does not, however, qualify for any additional R&D relief.

When the capital assets are sold, the proceeds are treated as a balancing charge and are therefore taxed as trading income.



Test your understanding 6

Gul Ltd is a small sized company for the purposes of R&D expenditure and pays corporation tax at the small profits rate. In the year ended 31 December 2023 it spent £8,500 on qualifying R&D expenditure.

Advise Gul Ltd of any tax relief available in respect of its expenditure.



4 Intangible assets

Intangible assets include the following items:

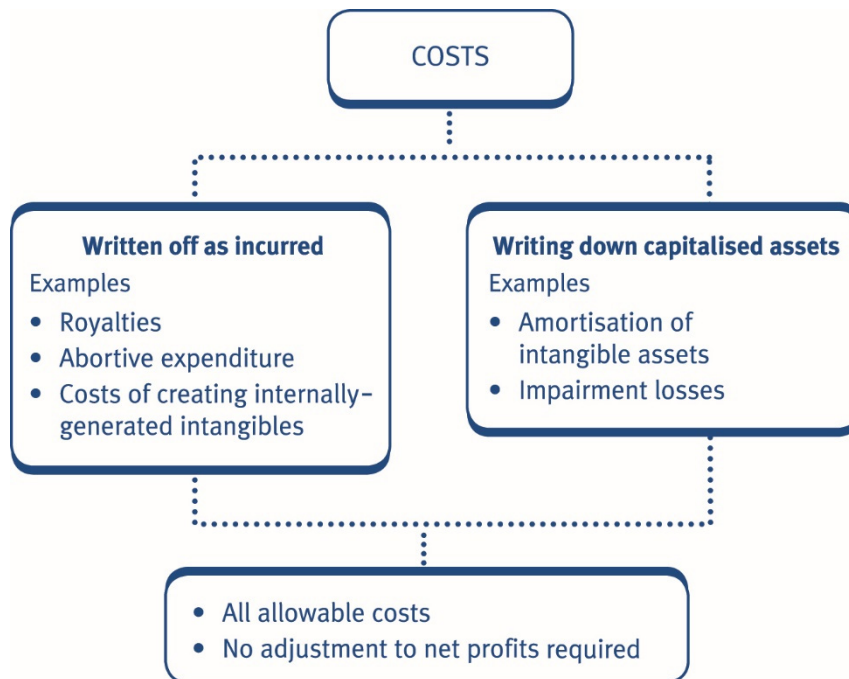
- purchased goodwill (not goodwill on consolidation)
- patents, copyrights and trademarks
- brands
- intellectual property and know-how.

Tax treatment of intangibles other than goodwill

The tax treatment of intangible assets other than goodwill broadly follows the accounting treatment. This is providing the accounting treatment is in accordance with GAAP (either UK or international).



Expenditure relating to intangibles which has been charged in the company's statement of profit or loss is allowable for tax purposes.



Election – alternative tax treatment

Instead of allowing the amounts charged in the accounts, an election can be made:

- to write off the cost of a capitalised intangible asset/intellectual property against profit for tax purposes at a rate of 4% per annum
- any accounting debits for amortisation or impairment losses would then be disallowed.

This is useful where:

- (1) the asset is amortised at a rate of less than 4%, or
- (2) the asset is not amortised in the accounts.

The allowable amount is calculated pro rata for accounting periods of less than 12 months.

The election is:

- irrevocable, and
- must be made within two years of the end of the accounting period in which the asset was acquired or created.



Test your understanding 7

On 1 December 2023 Rom plc purchased the trade and assets of another company in the same business sector. Rom plc paid £2 million that included £35,000 for a patent with a ten-year life remaining and £200,000 for a brand name.

The patent is capitalised and will be written off on a straight-line basis over ten years on a month-by-month basis.

The brand name is capitalised but not amortised.

Rom plc has an accounting reference date of 31 March each year.

What relief is available to Rom plc for its intangible assets?

Disposals

On the disposal of an intangible asset, the proceeds of sale are compared with the tax written down value to give a profit/loss.

- Any profit or loss made on disposal of an intangible asset in the accounts:
 - will give rise to an identical tax profit or loss
 - unless the tax written down value at the time of disposal differs from the accounts value
 - this occurs when the 4% election has been made.



Test your understanding 8

Assume that Rom plc in the previous illustration decides to sell the business that it bought on 1 December 2023. The consideration includes £38,000 for the patent and £250,000 for the brand name. The sale is made on 1 April 2026.

State the effect for tax purposes of the disposal of the intangible assets.

Tax treatment of goodwill

Goodwill purchased is treated differently from other intangible assets.



Amortisation or impairment losses relating to goodwill are **not allowable** for tax purposes.

Disposals

On disposal of goodwill, the proceeds of sale are compared with the cost to give a profit/loss.

- Any **profit** will be treated as a **trading** profit

- However, any **loss** will be treated as a **non-trading debit** and can be:
 - set off against total profits of the current period
 - group relieved if part of a 75% group (Chapter 4)
 - carried forward and offset against total profits of future periods (see Chapter 3).
- There is no option to carry back non-trading debits arising on the sale of goodwill.

Special intangible rollover relief

- If a profit is made on disposal of any intangible asset and a new intangible asset is acquired within 12 months before or up to 36 months after disposal:
 - part of the taxable profit may be deferred.
- The maximum deferral
 - = (Lower of disposal proceeds or amount reinvested)
Less: Cost of the original intangible asset
- Special intangible rollover relief is available for goodwill as well as other types of intangible asset.



Test your understanding 9

Maine plc sold an intangible asset for £30,000. The asset had an original cost of £20,000 and had a TWDV of £12,000 at the time of the sale.

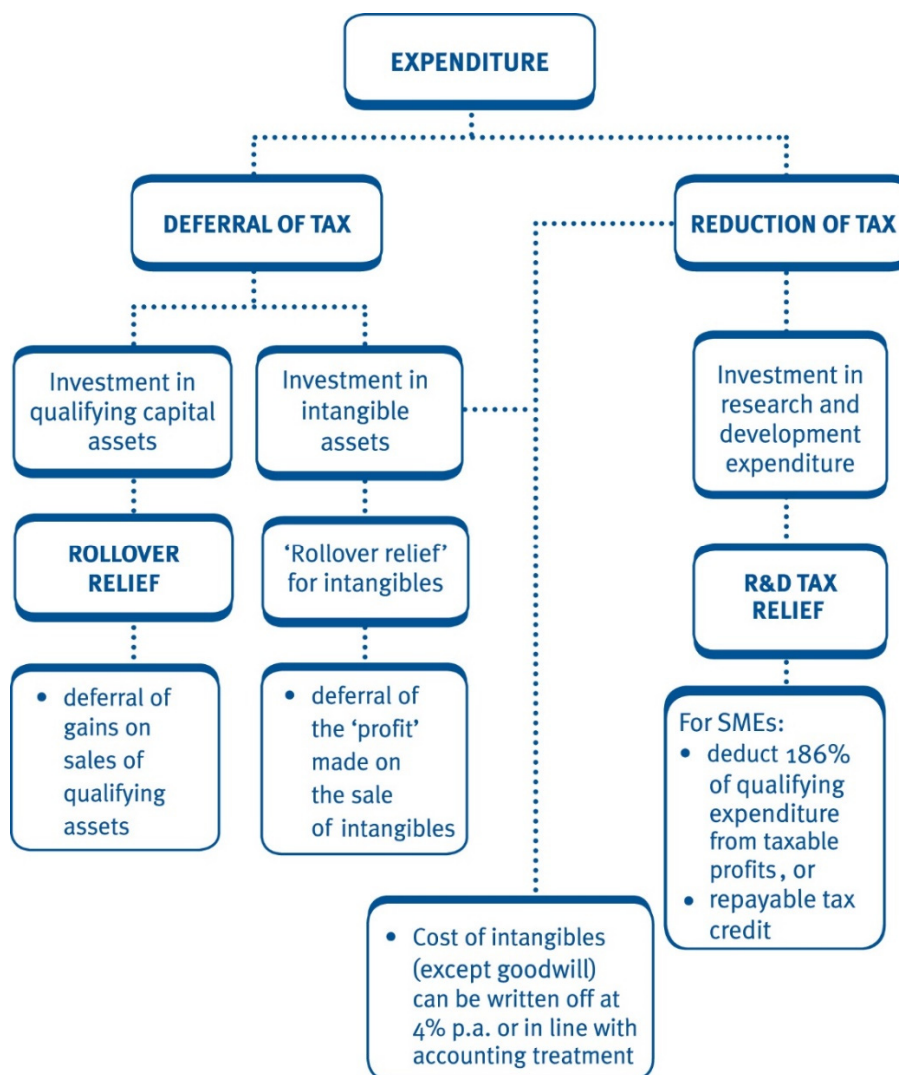
Maine plc purchased another intangible asset three months later.

Calculate the taxable profit if intangibles rollover relief is claimed and the new intangible cost:

- (a) **£35,000**
- (b) **£25,000**

5 Expenditure that reduces tax

We saw earlier in the chapter that certain types of investment and other expenditure can result in a reduction of tax liabilities for a company. The main points are mentioned below.



Note that capital allowances can also reduce tax liabilities but are not considered further here.



Illustration 4 – Expenditure that reduces tax

Rose plc is a profitable trading company that prepares its accounts to 31 March each year. It is not part of a group. In the year ended 31 March 2023 the company had taxable total profits of £800,000 and is budgeting £1,200,000 for the year ended 31 March 2024 before considering either of the transactions mentioned below.

It is now September 2023 and the company is considering the following:

- (1) Purchase of a new headquarters building for £375,000. This is to replace its old building which it sold in March 2023 for £410,000, giving rise to a chargeable gain of £90,000 which is included in the profits of £800,000 mentioned above.
- (2) Starting a research and development project to develop a revolutionary new product. Rose plc estimates that it will spend £100,000 on staff costs for the staff working on the project and £30,000 on consumables in the year ended 31 March 2024.

Rose plc is an SME for the purposes of R&D.

Explain the corporation tax consequences of the two transactions and calculate the tax savings.

Solution

(1) Purchase of new headquarters

The company made a gain of £90,000 in March 2023 which was included in its TTP of £800,000. As the company has made an investment in a new building there is a possible ROR claim.

Chargeable gain now

	£
Proceeds of sale of old building	410,000
Less: Cost of new building	(375,000)
	<hr/>
Proceeds not reinvested	35,000
	<hr/>
	£
Gain on old building	90,000
Less: ROR (bal. fig.) (£90,000 – £35,000)	(55,000)
	<hr/>
Gain remaining (= proceeds not spent)	35,000
	<hr/>

Base cost of new building:	£
Original cost	375,000
Less: Gain rolled over	(55,000)
	<hr/>
	320,000
	<hr/>

This claim will reduce the total profits for the y/e 31 March 2023 by £55,000 which will save the company tax at 19% (FY2022).

Therefore, Rose plc will have £10,450 ($£55,000 \times 19\%$) less to pay at the normal payment date for the y/e 31 March 2023 of 1 January 2024.

The ROR claim must be made within four years from 31 March 2024 (being the later of the AP in which the asset is sold or replaced).

(2) Research and development expenditure

As Rose plc is an SME it is entitled to claim extra R&D relief for any qualifying revenue expenditure that it incurs.

Staff costs and consumables are examples of qualifying revenue expenditure.

These costs would already be deductible against trading profits, but Rose plc can now claim to deduct an extra 86% on top of its normal deduction. The total deduction for the y/e 31 March 2024 would therefore be:

$$(\pounds 100,000 + \pounds 30,000) \times 186\% = \pounds 241,800$$

This would lead to a corporation tax saving at the main rate for FY2023 of:

$$\pounds 241,800 \times 25\% = \pounds 60,450$$



6 Transfer pricing

Aim of the legislation

Transfer pricing adjustments may be necessary for transactions between connected companies. Companies are connected if:

- one company directly or indirectly participates in the management, control or capital of the other company, or
- a third party directly or indirectly participates in the management, control or capital of both companies.

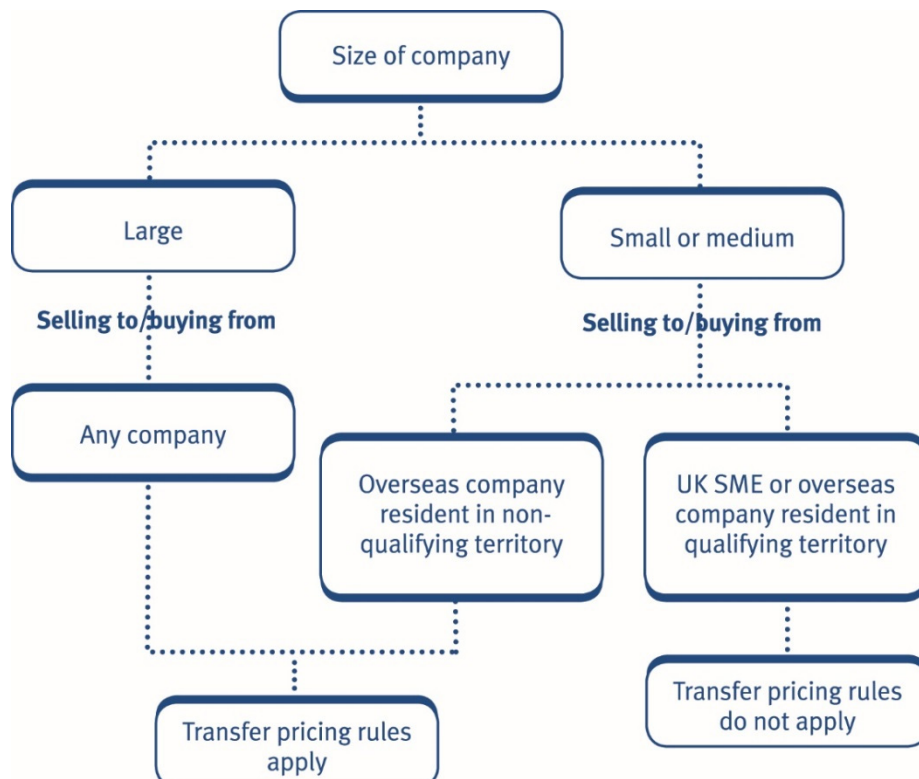
The transfer pricing rules apply to both transactions with non-UK resident companies and UK transactions.

HMRC wants to ensure that companies cannot manipulate total UK corporation tax by substituting a transfer price that is below or above an arm's length price.

- The transfer pricing legislation covers not only sales but also lettings/hiring of property and loan interest.
- Where transfer pricing policies are under review the basic aim is to **ensure transactions are recorded at an arm's length price**.
- Arm's length means the price which might have been expected if the parties had been independent persons dealing with each other in a normal commercial manner unaffected by any special relationship between them.
- An adjustment may be necessary to increase the profits of the advantaged company (i.e. the one gaining a tax advantage from the favourable price).
- If both parties are UK resident companies, the non-advantaged company may make an equal and opposite adjustment to its TTP.
- A company must adjust its own profits under self-assessment, and must pay any additional tax due.
- Alternatively, the company may enter into an Advance Pricing Arrangement with HMRC, to agree that its transfer pricing policy is acceptable and avoid the need for subsequent adjustments.

Companies covered by the legislation

Not all companies are affected by the legislation. The following diagram summarises the position:





The question in the exam will state if the company is 'large' or 'small' or 'medium'.

A medium sized company will be treated in the same way as a large company if there is 'manipulation' (for example, where there is a deliberate attempt to divert profits to a company paying at lower tax rate). If so, the transfer pricing rules will apply to that medium company on all transactions with any company.

A non-qualifying territory means one that is:

- not in the UK
- has no DTR agreement with the UK, or
- if it does have an agreement, that agreement does not have a non-discrimination clause.

It is also possible for the Treasury to designate countries as non-qualifying.



Test your understanding 10

Transaction	A Ltd	Subsidiary (B Ltd)
(1) A Ltd sells 5,000 units to B Ltd at £1.50 each when the MV = £3 each	UK company (large)	Overseas company
(2) As for (1)	UK company (medium/small)	UK company (medium/small)
(3) As for (1)	UK company (large)	UK company
(4) A Ltd makes a loan of £200,000 to B Ltd and charges interest at 2% when the commercial rate is 8%.	UK company (large)	Overseas company
(5) As for (4)	UK company (medium/small)	UK company (medium/small)
(6) As for (4)	UK company (large)	UK company
Explain the effect of the transfer pricing legislation on each transaction.		



Thin capitalisation

When a UK company pays a dividend, there is no tax relief for the payment. When it pays loan interest, the interest is tax allowable. This means that companies may prefer to be financed through loans (debt) rather than through shares (equity).

The thin capitalisation rules aim:

- to stop UK companies from getting excessive tax relief on interest.

This occurs:

- usually because they have received a loan from a related party that exceeds the loan an independent lender would be prepared to lend.

The rules ensure that:

- **interest** on the part of the **loan that an independent third party would be prepared to lend the company is allowable.**
- the **excess is disallowed.**
- the borrowing capacity of the individual company and its subsidiaries is considered (but not the rest of the group).

Factors determining thin capitalisation

HMRC will usually look at two areas to determine whether it believes a company is thinly capitalised:

(1) Gearing:

- This is the relationship of debt to equity.
- In the UK this is usually around 50:50.
- A higher proportion of debt could cause thin capitalisation problems.

(2) Interest cover:

- This is the ratio of earnings before tax and interest to loan interest.
- It measures how risky the loan is for the lender.
- Many commercial lenders will look for a ratio of around 3.



Test your understanding 11

Archer plc is a wholly owned subsidiary of Berry Inc, a company resident in Babylonia. Archer plc borrows £100,000 from Berry Inc paying a market rate of interest of 8%. Archer plc had to borrow from Berry Inc as their UK bankers were not prepared to lend them more than £60,000.

Advise Archer plc of how much loan interest they are likely to have relieved for tax purposes.



7 Companies with investment business

A company with investment business is a company 'whose business consists wholly or partly in the making of investments'. This includes any company that makes and holds investments, regardless of whether or not it also carries on a trade.

The costs incurred by such a company in managing its investments are allowable when computing its corporation tax liability in accordance with the rules set out below.

Profits of a company with investment business

The taxable total profits of a company with investment business:

- are calculated in the same way as for a trading company
- the same rules for the various sources of income and capital gains apply (for example, that costs relevant to a property business will be deducted from the property income).

Management expenses

Management expenses are incurred in managing the company's investments and can be deducted from the company's 'total profits', subject to the normal rules regarding deductibility of expenditure.

Accordingly, expenses such as depreciation of office furniture would not be allowable but capital allowances would be calculated and allowed instead, and business entertaining expenses would not be allowable.

Expenses which the courts have allowed as management expenses include:

- directors' fees and commissions, provided they are not excessive
- salaries of management
- audit fees
- office rent and rates
- bank interest.

Excess management expenses can be:

- carried forward and offset against total profits of future periods (Chapter 3)
- group relieved if part of a 75% group (Chapter 4).



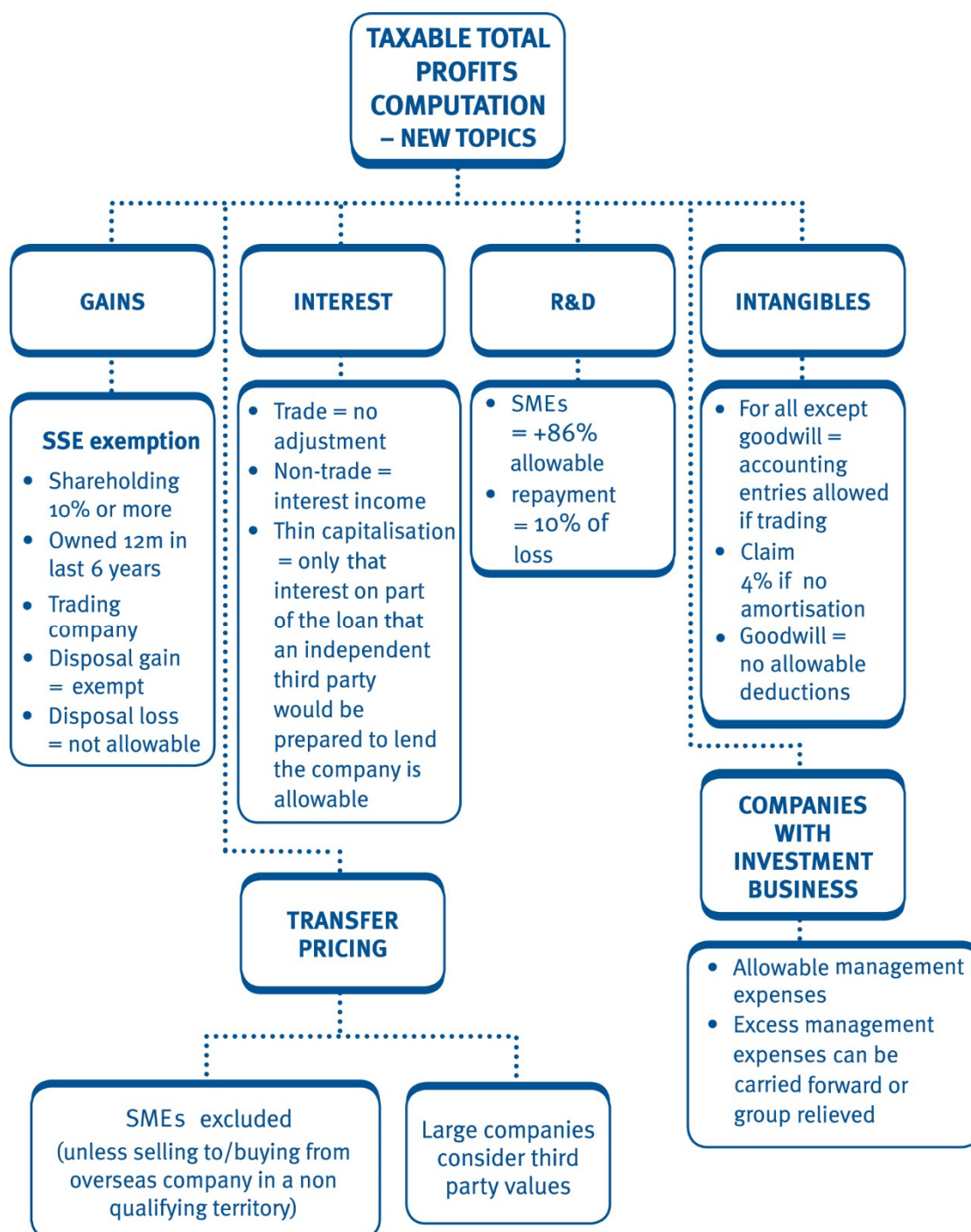
Test your understanding 12

Cheetah Ltd has the following results for the year ended 31 March 2024:

	£
Rental income	70,000
Deposit account interest receivable	20,000
Chargeable gains	3,000
Management expenses:	
Property management	35,000
Other	60,000
Capital allowances:	
Related to property business	2,300
Other	1,600
Loan stock interest payable (gross)	2,000
Directors' remuneration	3,000

Calculate Cheetah Ltd's CT liability for the y/e 31 March 2024.

8 Chapter summary



Test your understanding answers



Test your understanding 1

Peacock plc

(a) **Capital allowances for the year ended 31 December 2023**

Plant and machinery

AIA $\text{£}100,000 \times 100\% = \text{£}100,000$

Structures and buildings allowance

$\text{£}450,000 \times 3\% \times 1/12 = \text{£}1,125$

Note: Only the construction costs are eligible for SBA. Land, stamp duty land tax and legal fees are not eligible costs.

SBA can only be claimed from the date the asset is brought into use in the business.

(b) **Sale of the head office**

Peacock plc (seller)

SBAs are available to the date of disposal (1 April 2025).

The allowance for the year ended 31 December 2025 would be $\text{£}3,375$ ($\text{£}450,000 \times 3\% \times 3/12$).

Peacock plc would have a chargeable gain which would be calculated as the sale proceeds of $\text{£}1,000,000$ less the cost of the land, construction, legal fees and stamp duty land tax of $\text{£}661,000$ ($\text{£}200,000 + \text{£}450,000 + \text{£}10,000 + \text{£}1,000$).

The total SBAs claimed to date of $\text{£}18,000$ ($\text{£}1,125 + \text{£}13,500 + \text{£}3,375$) would be added to the proceeds when calculating the gain.

Flamingo Ltd (buyer)

Flamingo Ltd takes over the balance of qualifying expenditure for the remaining useful life. The price it pays for the office is irrelevant.

Flamingo Ltd can claim SBAs of $\text{£}10,125$ ($\text{£}450,000 \times 3\% \times 9/12$) in the year ended 31 December 2025, as the building is put into use in its trade from 1 April 2025.

In subsequent years SBAs of $\text{£}13,500$ ($\text{£}450,000 \times 3\%$) can be claimed until the original eligible cost is fully relieved.



Test your understanding 2

Stella Ltd

	£
Sale proceeds	3,500,000
Less: Cost	(700,000)
Enhancement expenditure	(200,000)
	<hr/>
Unindexed gain	2,600,000
Less: Indexation allowance	
On Cost:	
June 1999 to December 2017	
$0.679 \times £700,000$	(475,300)
On Enhancement expenditure:	
October 2005 to December 2017	
$0.439 \times £200,000$	(87,800)
	<hr/>
Indexed gain	2,036,900
Less: Rollover relief (Note)	(0)
	<hr/>
Chargeable gain	2,036,900
	<hr/>

Note: Rollover relief

ROR is not available as insufficient sale proceeds were reinvested in qualifying assets.

The chargeable gain arising = lower of:

- (1) all of the indexed gain = £2,036,900
- (2) sale proceeds not reinvested
 $= (£3,500,000 - £1,400,000) = £2,100,000$



Test your understanding 3

Omega Ltd

Both of these disposals will qualify for the SSE.

- The first disposal of the 10% holding has been held for a 12-month period in the six years prior to disposal.
- The second disposal also qualifies, despite it being made out of only a 5% holding, because Omega Ltd held at least a 10% holding throughout a 12-month period during the six years prior to this second disposal.



Test your understanding 4

Arable Ltd

(a) Corporation tax computation – p/e 31 December 2023

	£
Trading profit	345,206
P & M – Capital allowances (W1)	(144,649)
Deduction for lease premium (W2)	(2,700)
	<hr/>
Tax adjusted trading profit	197,857
Property income (W3)	49,700
Interest income (£6,000 + £3,000)	9,000
Chargeable gain (W4)	25,829
	<hr/>
TTP	282,386
	<hr/>
Corporation tax liability (W5) (£282,386 × 25%)	70,597
	<hr/>

Note: The dividend received is exempt from corporation tax.

Workings

(W1) Plant and machinery

	AIA/FYA £	Main pool £	Special rate pool £	Allowances £
p/e 31 December 2023				
Additions:				
Not qualifying for AIA or FYA:				
Cars (1 – 50g/km)		11,200		
Cars (over 50g/km)			14,600	
Qualifying for AIA				
Plant and machinery (Note 1)	129,480			
AIA	(129,480)			129,480
	<hr/>	0		
		<hr/>		
		11,200	14,600	
WDA (18% × £11,200 × 9/12)		(1,512)		1,512
WDA (6% × £14,600 × 9/12)			(657)	657
Zero emission car	13,000			
FYA (100%)	(13,000)			13,000
	<hr/>	0		
		<hr/>		
TWDV c/f		9,688	13,943	
		<hr/>	<hr/>	
Total allowances				144,649
				<hr/>

Notes:

- (1) Plant qualifying for AIA
 $= (£79,380 + £3,700 + £42,000 + £4,400) = £129,480$

(W2) Deduction for lease premium

The leasehold building has been used for business purposes, and so a proportion of the lease premium assessed on the landlord can be deducted.

The amount assessed on the landlord calculated as follows:
 $£75,000 \times [(51 - 15)/50] = £54,000$

This is deductible over the life of the lease, so the deduction for the nine-month period ended 31 December 2023 is:
 $(£54,000/15 = £3,600 \times 9/12) = £2,700$

(W3) Property income

	£
Old warehouse	
Premium assessed as property income	
$£50,000 \times [(51 - 5)/50]$	46,000
Rent receivable ($£14,800 \times 3/12$)	3,700
	<hr/>
Property income	49,700
	<hr/>

(W4) Chargeable gain on the disposal of shares

The substantial shareholding exemption does not apply as Arable Ltd's shareholdings never represented more than a 1% interest in Ranch plc.

	£
Disposal proceeds	37,574
Less: Cost (see below)	(11,625)
	<hr/>
Unindexed gain	25,949
Less: Indexation	(120)
$(£11,745 - £11,625)$ (see below)	
	<hr/>
Chargeable gain	25,829
	<hr/>

Share pool	Number	Cost £	Indexed cost £
Pool b/f	20,000	23,250	23,490
Disposal (December 2023)	(10,000)	(11,625)	(11,745)
Balance c/f	10,000	11,625	11,745
(W5) Rate of corporation tax			
			£
TTP			282,386
Plus: Dividend received			20,000
Augmented profits			302,386
Lower limit ($£50,000 \times 9/12$)			37,500
Upper limit ($£250,000 \times 9/12$)			187,500
Augmented profits are above the upper limit so the main rate applies.			
The AP falls entirely within FY2023.			
(b) Self-assessment corporation tax return			
Arable Ltd's self-assessment corporation tax return for the p/e 31 December 2023 must be submitted online by 31 December 2024.			
It will be possible for Arable Ltd to amend its return at any time before 31 December 2025, being 12 months after the filing date.			
If an error or mistake in a return is subsequently discovered, then Arable Ltd can make a claim for relief before 31 December 2027, being four years from the end of the accounting period.			



Test your understanding 5

Dax plc

Dax plc is an SME; it can claim an additional R&D deduction against its taxable profits as follows:

Allowable expenses but not qualifying for additional relief:	£
Market research	8,000
Administrative staff	5,000
	<hr/>
	13,000
	<hr/>
Allowable expenses qualifying for additional relief:	
Staff	20,000
Heat and light	9,000
Software	4,000
Agency staff	10,000
	<hr/>
	43,000
	<hr/>
× 186%	79,980
	<hr/>
Allowable amount (£79,980 + £13,000)	92,980
	<hr/>

Note: £92,980 is the total allowable amount, but the actual expenses of £56,000 (£43,000 + £13,000) will already have been charged in the statement of profit or loss. Therefore, an additional £36,980 (£92,980 – £56,000) is deducted in the adjustment to profits computation.



Test your understanding 6

Gul Ltd

Normal relief for R&D expenditure

The normal R&D expenditure allowable deduction already charged in the accounts of £8,500 will give a tax saving of £1,615 ($£8,500 \times 19\%$).

Extra deduction

Gul Ltd can claim an extra deduction of 86% on its £8,500 qualifying expenditure giving an additional tax saving as follows:

	£
Allowable R&D deduction ($86\% \times £8,500$)	7,310
	<hr/>
Corporation tax saving ($19\% \times £7,310$)	1,389
	<hr/>

Total tax saving = ($£1,615 + £1,389$) = £3,004



Test your understanding 7

Rom plc

(1) Patent

- This is being amortised at 10% per annum.
- The accounting treatment = tax allowable amount.
- Therefore £3,500 p.a. ($£35,000 \times 10\%$) will be the amortisation and tax allowable amount, and no adjustment to profits is required.
- The allowable amount is £1,167 ($4/12 \times £3,500$) in the year ended 31 March 2024 as amortisation is calculated on a monthly basis and the patent was acquired on 1 December 2023.
- A 4% election should not be made as the tax allowable amount would be less than the amortisation available.

(2) Brand name

- This is not being amortised.
- It will therefore be beneficial for the company to elect to write this off for tax purposes at 4% per annum.
- An allowance of £8,000 ($£200,000 \times 4\%$) will be available.
- Therefore £8,000 should be deducted in the adjustment of profits computation.

Note: The full annual allowance is available in the year ended 31 March 2024 as the accounting period is 12 months in length. It is irrelevant when in the accounting period the brand name was purchased.



Test your understanding 8

Rom plc continued

Patent	£
Original cost	35,000
Less: Amounts written off	
Year ended 31 March 2024	(1,167)
Year ended 31 March 2025	(3,500)
Year ended 31 March 2026	(3,500)
	<hr/>
TWDV at 1 April 2026	26,833
Proceeds	38,000
	<hr/>
Profit (included in taxable trading profits)	11,167
	<hr/>

Brand name

As the 4% election has been made, the company cannot follow the accounts in relation to the profit arising on the brand name.

Any accounting profit is deducted for tax purposes in the adjustment of profits computation and is replaced with the following taxable profit.

	£
Original cost	200,000
Less: Amounts written off	
Year ended 31 March 2024	(8,000)
Year ended 31 March 2025	(8,000)
Year ended 31 March 2026	(8,000)
	<hr/>
TWDV at 1 April 2026	176,000
Proceeds	250,000
	<hr/>
Profit (included in taxable trading profits)	74,000
	<hr/>



Test your understanding 9

Maine plc

(a) New intangible cost £35,000

Profit on disposal

	£	£	£
Sale proceeds			30,000
Less: TWDV			(12,000)
			<hr/>
Trading profit			18,000
Rollover relief:			
Lower of:			
– Proceeds	30,000		
– Amount reinvested	35,000		
i.e. Proceeds		30,000	
Less: Cost of original asset		(20,000)	
		<hr/>	
Amount deferred			(10,000)
			<hr/>
Taxable trading profit			8,000
			<hr/>

Note: The £8,000 that cannot be deferred is equal to the amount of amortisation that was claimed on the original asset (£20,000 – £12,000 = £8,000).

(b) New intangible cost £25,000

Profit on disposal

	£	£	£
Sale proceeds			30,000
Less: TWDV			(12,000)
			<hr/>
Trading profit			18,000
Rollover relief:			
Lower of:			
– Proceeds	30,000		
– Amount reinvested	25,000		
i.e. Amount reinvested		25,000	
Less: Cost of original asset		(20,000)	
		<hr/>	
Amount deferred			(5,000)
			<hr/>
Taxable trading profit			13,000
			<hr/>

Note: The £13,000 not deferred is equal to the amortisation claimed on the original asset (£20,000 – £12,000 = £8,000) plus the proceeds not reinvested (£30,000 – £25,000 = £5,000).



Test your understanding 10

A Ltd and B Ltd

- (1) The transfer pricing legislation applies.
A Ltd must increase its taxable total profits by £7,500 ($£1.50 \times 5,000$). The £1.50 adjustment is the difference between market value and the price at which the units were sold.
- (2) The transfer pricing legislation does not apply, unless a medium company and HMRC considers profits are being manipulated.
- (3) The transfer pricing legislation applies.
A Ltd must increase its taxable total profits by £7,500 and B Ltd may make an equal and opposite adjustment to its taxable total profits as it is UK resident.
- (4) The transfer pricing legislation applies.
A Ltd must increase its taxable total profits by £12,000 ($6\% \times £200,000$). 6% represents the difference between the commercial rate of interest and the rate that was actually charged.
- (5) The transfer pricing legislation does not apply.
- (6) The transfer pricing legislation applies.
A Ltd must increase its taxable total profits by £12,000 and B Ltd may make an equal and opposite adjustment to its taxable total profits as it is UK resident.



Test your understanding 11

Archer plc

A third party was only prepared to lend Archer plc £60,000.

As it has borrowed £100,000 from its parent company, it is likely that interest on the excess £40,000 will be disallowed for tax purposes.

Of the £8,000 ($£100,000 \times 8\%$) interest paid to Berry Inc, only £4,800 ($£60,000 \times 8\%$) is likely to be allowed for tax.



Test your understanding 12

Cheetah Ltd

Corporation tax computation – year ended 31 March 2024

	£
Property income (W1)	32,700
Interest income (£20,000 – £2,000)	18,000
Chargeable gains	3,000
	<hr/>
Total profits	53,700
Less: Management expenses (restricted) (W2)	(53,700)
	<hr/>
TTP	0
	<hr/>
Corporation tax liability	0
	<hr/>

Workings

(W1) Property income

	£
Rents	70,000
Less: Capital allowances	(2,300)
Property management expenses	(35,000)
	<hr/>
Property income	32,700
	<hr/>

(W2) Management expenses

	£
General management expenses	60,000
Directors' remuneration	3,000
Capital allowances	1,600
	<hr/>
	64,600
Less: Total profits	(53,700)
	<hr/>
Excess management expenses	10,900
	<hr/>

Excess management expenses are carried forward and can be offset against total profits of future periods.

Corporation tax losses

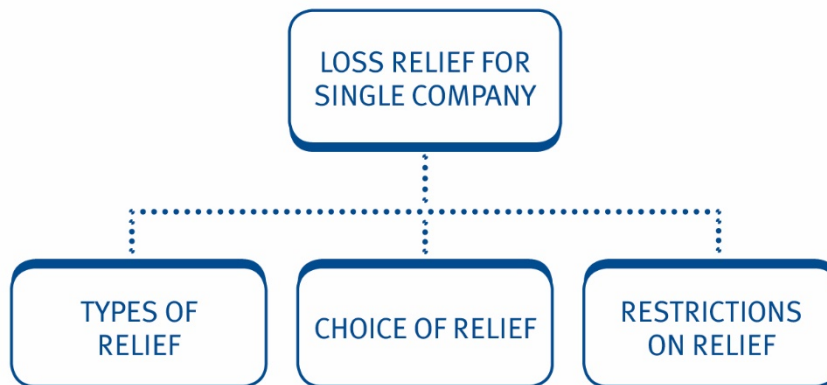
Chapter learning objectives

Upon completion of this chapter you will be able to:

- explain and show the alternative methods for relieving a range of losses in a single company
- determine the tax treatment of non-trading deficits on loan relationships
- advise on the restriction on the use of losses on a change in ownership of a company
- identify the restriction on carried forward trading losses and capital losses for companies with profits over £5 million
- understand the statutory obligations imposed in a given situation, including any time limits for action and advising on the implications of non-compliance
- advise on legitimate tax planning measures, by which the tax liabilities arising from a particular situation or course of action can be mitigated
- advise on the mitigation of tax in the manner recommended by reference to numerical analysis and/or reasoned argument.



One of the PER performance objectives (PO17) is to advise on mitigating and deferring tax liabilities through legitimate tax planning measures. Loss reliefs are a good example of how tax can be mitigated. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter covers the rules for loss reliefs available to a single company.



Much of this chapter is a revision of rules covered at TX. A brief reminder of TX content is given in supplementary reading and revision examples are provided to check your retention of the required TX knowledge.

The new areas at ATX are

- the treatment of non-trading loan relationship (NTLR) deficits, and
- the restrictions for the use of some losses.

There is also a much greater emphasis at ATX on choosing the most tax efficient use of loss reliefs available and tax planning for companies with losses.

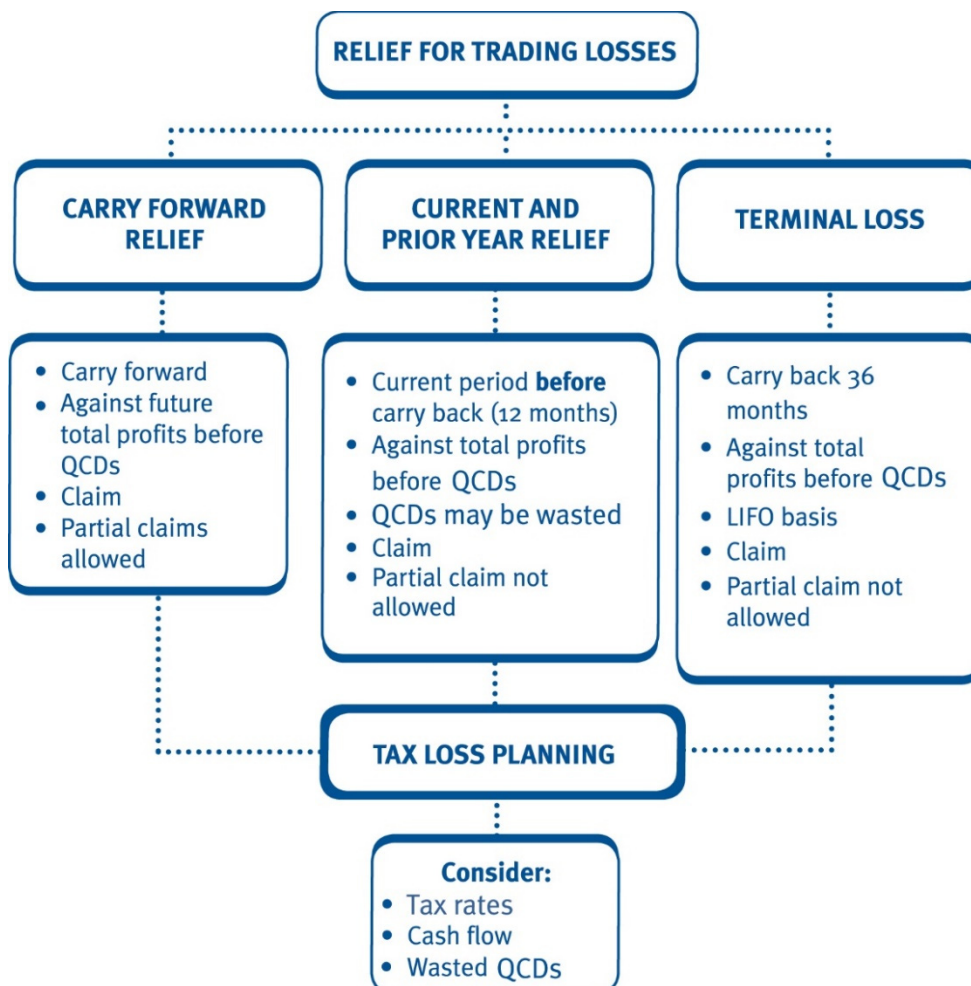


There are several professional skills that could be tested in exam questions involving the use of loss reliefs, such as: your ability to analyse information and evaluate possible options for relief, your communication skills in explaining the impact of these options to your client and also your commercial acumen in relation to the availability of reliefs.

1 Loss reliefs for a single company

A revision of trading loss reliefs available

The following diagram summarises the trading loss relief options to a single company covered at TX:



Carry forward loss relief

The key features of this relief are:

- The loss is carried forward for offset in future accounting periods.
- The loss is set against **total profits before qualifying charitable donations (QCDs)**.
- It is possible to restrict the amount of loss relieved.
- The loss can be carried forward indefinitely.
- There is no need to make a current year or a prior year claim first.
- A claim must be made within two years of the end of the accounting period **in which the loss is relieved**.



Trading losses

- The current year and carry back reliefs need to be claimed within two years of the end of the AP in which the trading loss occurred.
- The carry back option can only be considered after claiming in the current period.
- Any trading loss remaining after a current year claim can be carried back against total profits before qualifying charitable donations (QCDs) of the preceding 12 months. The carry back is optional.
- On cessation of trade only, the trading loss of the last 12 months can be carried back 36 months on a LIFO basis.
- If there are trading losses remaining after a current year/carry back claim, or no such claims are made, the loss is carried forward indefinitely for relief, as set out above.

Trading losses – pro forma computation

When dealing with losses it is necessary to have a neat and logical layout for computations.

Pro forma: Corporation tax losses

(Loss arises in 2023)	2022	2023	2024
	£	£	£
Trading profit	X	0	X
Other income	X	X	X
Net chargeable gains	X	X	X
	<hr/>	<hr/>	<hr/>
Total profits	X	X	X
Less: Loss relief			
– Current period		(X)	
– Carry back	(X)		
– Carry forward			(X)
	<hr/>	<hr/>	<hr/>
	0	0	X
Less: QCDs	Wasted	Wasted	(X)
	<hr/>	<hr/>	<hr/>
Taxable total profits	0	0	X
	<hr/>	<hr/>	<hr/>

Note: Unlike income tax, for companies there is no maximum deduction for current period and carry back losses (see Chapter 21).

Loss-making period of less than 12 months

The length of the loss-making period is not important:

- Full relief is given against the current period total profits before QCDs.
- The remaining loss can be carried back in full in the normal way.

Short accounting periods prior to year of loss

If any of the accounting periods falling in the carry back period are less than 12 months:

- The profits of the accounting period that falls partly into the carry back period must be time apportioned.
- The loss can only be offset against those profits which fall within the carry back period.
- Remember, the loss is offset on a LIFO basis (i.e. against the later accounting period first).



Illustration 1 – Short account period prior to the loss

If the AP immediately preceding the loss-making y/e 31 December 2024 is the eight m/e 31 December 2023, then the loss can be carried back:

- against the eight m/e 31 December 2023, and then if sufficient loss
- against 4/12 of the total profits before QCDs of the 12 months to 30 April 2023.



Non-trading losses



In addition to trading losses four other types of loss can occur.

The following table summarises the non-trading loss relief options for a single company:

Relief:	Capital losses	Property business losses	Non-trade loan relationship (NTLR) deficits	Management expenses
Current year	<ul style="list-style-type: none"> • Against chargeable gains only • Automatic • Partial claims not allowed 	<ul style="list-style-type: none"> • Against total profits before QCDs • Automatic • Partial claims not allowed 	<ul style="list-style-type: none"> • Against total profits before QCDs • Claim within two years of end of AP of loss • Partial claims are allowed 	<ul style="list-style-type: none"> • Against total profits before QCDs • Automatic • Partial claims not allowed
Carry back	N/A	N/A	<ul style="list-style-type: none"> • Against NTLR profits only • Claim within two years of end of AP of loss • Partial claims are allowed 	N/A

Carry forward	<ul style="list-style-type: none"> • Against future chargeable gains only • Automatic • Partial claims not allowed • Offset restricted to £5 million + 50% of remaining gains after deducting £5 million 	<ul style="list-style-type: none"> • Against future total profits before QCDs • Claim within two years of end of AP in which relieved • Partial claims are allowed 	<ul style="list-style-type: none"> • Against future total profits before QCDs • Claim within two years of end of AP in which relieved • Partial claims are allowed 	<ul style="list-style-type: none"> • Against future total profits before QCDs • Claim within two years of end of AP in which relieved • Partial claims are allowed
Group relief	No – but can reallocate capital losses within a gains group (Chapter 4)	Excess current year and b/f losses (Chapter 4)	Current year and excess b/f losses (Chapter 4)	Excess current year and b/f expenses (Chapter 4)



Illustration 2 – Loan relationship deficits

Lily Ltd has the following results for the year ended 31 March 2024:

	£
Trading profits (before taking account of interest)	105,000
Property income	62,000
Interest receivable on building society deposit	21,000
Interest payable on loan stock used to purchase rental property	42,000
Legal fees payable in respect of above issue of loan stock	6,000
Interest payable on loan to fund working capital	8,000

Calculate Lily Ltd's taxable total profits for the year ended 31 March 2024, showing clearly how the loan relationship deficit may be relieved.

Solution**Corporation tax computation – year ended 31 March 2024**

	£
Trading profits	105,000
Less: Interest payable on loan to fund working capital	(8,000)
	<hr/>
Adjusted trading profit	97,000
Property income	62,000
	<hr/>
	159,000
Less: Deficit on NTLR (W)	(27,000)
	<hr/>
TTP	132,000
	<hr/>

Working: Deficit on non-trading loan relationship

	£
Interest receivable	21,000
Interest payable on loan to purchase rental property	(42,000)
Fees payable on loan to purchase rental property	(6,000)
	<hr/>
Deficit on NTLR	(27,000)
	<hr/>

Approach for loss computations

A question involving company losses often covers several years and may include one or more of property, NTLR and capital losses as well as trading losses. Therefore, a methodical approach is important.

- Step 1:** Write out the skeleton TTP pro forma, remembering to leave space for loss relief claims, and setting out the years side by side.
- Step 2:** Fill in the pro forma with the TTP information provided, ignoring loss relief.
- Step 3:** If there are any 'non-trading' losses identify each separately, in a separate loss working, and show the amounts used and carried forward. Deal with property losses and NTLR deficits before using the trading loss.
- Step 4:** In the year of the trading loss, the trading income is £Nil. Keep a separate working for the trading loss. If there are losses in more than one AP, keep a separate loss working for each loss and update the workings as the loss is relieved.

Step 5: Consider the alternative loss relief options available, reading carefully any guidance given in the requirement on the loss reliefs to consider or the objectives of the company.

- Where there is more than one loss to offset:
 - Deal with the earliest loss first.
- If a question states 'relief is to be obtained as early as possible', the order of set-off is:
 - Current year claim followed by a carry back claim to the previous 12 months (or 36 months for a terminal loss).
 - Carry forward any remaining loss and offset against future total profits (not an option in a terminal loss question).
- If a question asks you to 'identify and evaluate' the options available, consider each of the three options:
 - Current year claim, followed by a carry back claim and then carry forward any excess.
 - Current year claim and then carry forward any excess.
 - Carry forward only.

Identify the amount of tax saving, the loss of relief for QCDs and cash flow implications under each option (see section 2) and conclude as to which option is preferable.

Step 6: Calculate the revised TTP after the appropriate loss reliefs have been applied.



Illustration 3 – Loss computation

Daffodil Ltd has the following results for the four accounting periods ended 31 March 2027.

Year ended:	31.3.24	31.3.25	31.3.26	31.3.27
	£	£	£	£
Trading profit/(loss)	14,000	10,000	23,500	(25,000)
Interest income	2,200	1,800	2,000	2,400
Property income	800	1,100	(800)	800
Chargeable gains	0	(700)	0	2,600
QCDs	(200)	(200)	(200)	(200)

There was a trading loss brought forward at 1 April 2023 of £20,000. Daffodil continues to trade after 31 March 2027.

Calculate Daffodil Ltd's taxable total profits, assuming that loss relief is claimed as early as possible.

Solution

- There are two trading losses to consider:
 - £20,000 brought forward at 1 April 2023
 - £25,000 in the year ended 31 March 2027

The phrase 'as early as possible' in the requirement means that a current year claim should be made, then a carry back claim, for the loss of £25,000. Relief should be given for earlier trading losses before relief is given for later losses.

- The £20,000 brought forward trading loss can be set against total profits before QCDs, and the offset should be restricted to avoid wasting the QCDs.
- The capital loss can only be carried forward and used against future gains.
- The property loss should be deducted from total profits before QCDs of the accounting period of the loss.
- As each loss is relieved the loss working should be completed.

Corporation tax computations

Year to:	31.3.24	31.3.25	31.3.26	31.3.27
	£	£	£	£
Trading profit	14,000	10,000	23,500	0
Interest income	2,200	1,800	2,000	2,400
Property income	800	1,100	0	800
Chargeable gains (£2,600 – £700)	0	0	0	1,900
Total profits	17,000	12,900	25,500	5,100
Less:				
Property loss relief			(800)	
Trading loss relief				
– b/f	(16,800)	(3,200)		
– current AP				(5,100)
– carry back			(19,900)	
	200	9,700	4,800	0
Less: QCDs	(200)	(200)	(200)	Wasted
TTP	0	9,500	4,600	0

Loss working – trading losses	£
Loss carried forward at 1 April 2023	20,000
Less: Used in y/e 31 March 2024	(16,800)
Used in y/e 31 March 2025	(3,200)
	<hr/>
	0
	<hr/>
Loss for y/e 31 March 2027	25,000
Less: Used in current AP – y/e 31 March 2027	(5,100)
Used in 12 month carry back – y/e 31 March 2026	(19,900)
	<hr/>
	0
	<hr/>
Loss working – non-trading losses	£
Capital loss for y/e 31 March 2025	700
Less: Deducted from chargeable gains for y/e 31 March 2027	(700)
	<hr/>
	0
	<hr/>
Property business loss for y/e 31 March 2026	800
Less: Used against total profits of y/e 31 March 2026	(800)
	<hr/>
	0
	<hr/>



Test your understanding 1

Lost Ltd's results for the three accounting periods to 31 March 2025 are:

	y/e 30.6.23	p/e 31.3.24	y/e 31.3.25
	£	£	£
Trading profit/(loss)	86,600	20,800	(78,300)
Property income	0	4,500	5,600
Chargeable gain/(capital loss)	(3,000)	0	9,500
QCDs	(1,400)	(800)	(1,100)

- (a) **Assuming that Lost Ltd claims relief for its losses as early as possible, compute the company's taxable total profits for the three accounting periods to 31 March 2025.**

Your answer should clearly identify the amount of any losses that are unrelieved.

- (b) **Explain how your answer to (a) above would have differed if Lost Ltd had ceased trading on 31 March 2025.**

2 Choice of loss reliefs

Factors that influence choice of loss relief

Where there is a choice of loss reliefs available, the following factors will influence the loss relief chosen:

- Tax saving
- Cash flow
- Wastage of relief for QCDs.

Tax saving

The company will want to save (or obtain a refund at) the highest possible rate of tax.

Prior to FY2023, there was only one rate of corporation tax of 19% for several years. A claim to set losses against profits arising before 1 April 2023 will, therefore, always save tax at 19%.

However, since the introduction of two rates of corporation tax with marginal relief, it may be possible to save tax at higher rates.

The preferred order to claim relief to achieve the highest tax saving is against:

Profit subject to tax at:	Effective rate of tax saving:
	FY2023
1. Main rate less marginal relief (Note)	26.5%
2. Main rate	25%
3. Small profits rate	19%

Note: The effective rate of tax in the margin (or marginal rate) is not provided in the exam. You need to learn this.

You should be aware that this rate will only work if there are no dividends received from non-group companies. If you have a scenario involving dividends then a full computation before and after loss relief would be required to calculate the corporation tax saving. See the following illustration for details of where the 26.5% effective rate comes from.



Illustration 4 – Marginal rate of tax

A Ltd has taxable total profits of £50,000 for the year ended 31 March 2024. B Ltd has taxable total profits of £60,000 for the year ended 31 March 2024. Neither company received any dividends in the year.

A Ltd and B Ltd are unconnected companies.

Calculate the corporation tax liability payable by each company and the marginal rate of tax on the additional profits of £10,000 earned by B Ltd.

Solution

Year ended 31 March 2024

	A Ltd	B Ltd
	£	£
TTP = Augmented profits	50,000	60,000
	<hr/>	<hr/>
Corporation tax:		
£50,000 @ 19%	9,500	
£60,000 @ 25%		15,000
Less: Marginal relief		
(£250,000 – £60,000) × 3/200		(2,850)
	<hr/>	<hr/>
	9,500	12,150
	<hr/>	<hr/>

A Ltd's TTP is in line with the lower limit of £50,000, meaning it will pay corporation tax at the small profits rate of 19%.

B Ltd has an additional £10,000 of profits, which takes it into the marginal band (i.e. between the lower limit of £50,000 and upper limit of £250,000).

Additional tax paid by B Ltd compared to A Ltd = (£12,150 – £9,500) = £2,650

Additional taxable total profits earned by B Ltd = £10,000

Effective rate of tax on extra £10,000 of profits

= (£2,650/£10,000 × 100) = **26.5%**

Note: This effective rate is on profits in the marginal band only. The overall average effective rate of tax for B Ltd would be 20.25% (£12,150/£60,000 × 100).

The overall average effective rate for a marginal company will always be somewhere between 19% and 25%, meaning that even if using a loss to reduce profits into the marginal band, it will still be more beneficial than just reducing profits to the upper limit.

Cash flow

A company's cash flow position may affect its choice of loss relief.

A company may be prepared to accept loss relief at a lower rate, if it results in an earlier receipt of cash.

Note that when a loss is carried back, it will probably result in a repayment of corporation tax for the earlier period, whereas carrying the loss forward will only result in a reduction of a future liability. Therefore, for cash flow purposes it will be better to make a current year claim and then carry losses back.



Illustration 5 – Choice of loss relief

Fern Ltd has the following results for the three years ended 31 March 2025.

Year ended:	31.3.23	31.3.24	31.3.25
	£	£	£
Trading profit/(loss)	350,000	(270,000)	650,000
Property income	7,000	7,000	7,000
Chargeable gain	0	165,000	0
QCDs	(1,000)	(1,000)	(1,000)

Fern Ltd has not received any dividends in any of its accounting periods.

Set out and evaluate the options for loss relief for Fern Ltd.

Solution**Profits before loss relief**

Year ended:	31.3.23	31.3.24	31.3.25
	£	£	£
Trading profit	350,000	0	650,000
Property income	7,000	7,000	7,000
Chargeable gain	0	165,000	0
	<hr/>	<hr/>	<hr/>
Total profits	357,000	172,000	657,000
Trading loss relief			
– b/f			
– current AP			
– carry back			
Less: QCDs	(1,000)	(1,000)	(1,000)
	<hr/>	<hr/>	<hr/>
TTP	356,000	171,000	656,000
	<hr/>	<hr/>	<hr/>

Options for loss relief**(1) Carry forward**

A claim can be made to set the £270,000 trading loss against total profits before QCDs in the year ended 31 March 2025.

Due to the level of profits, there is no need to restrict the offset to avoid wasting the QCDs.

Tax will be saved at the main rate of 25%, as the loss will all be set against profits above the upper limit of £250,000.

The tax saving will be as follows:

	Loss offset	Effective rate	Tax saving
	£		£
Y/e 31 March 2025			
Profits above upper limit	270,000	× 25%	67,500
			<hr/>
Total saving			67,500
			<hr/>

The benefit for Fern Ltd would be obtained on 1 January 2026, the due date for payment of corporation tax for the year ended 31 March 2025.

(2) Current AP claim then carry forward

A claim can be made to set the loss against total profits before QCDs in the year ended 31 March 2024.

As the TTP falls between the upper and lower limits, the saving will be partly at the marginal rate of 26.5% (above £50,000) and partly at the small profits rate, on profits below the lower limit.

This is an all or nothing claim, so £172,000 of the loss will be set off, but tax will only be saved on £171,000 of the loss as the QCDs will be wasted.

This will leave a remaining loss of £98,000 (£270,000 – £172,000) which can be relieved against total profits before QCDs in the year ended 31 March 2025, saving tax at the main rate of 25%.

The tax saving will be as follows:

	Loss used £	Effective rate	Tax saving £
Y/e 31 March 2024			
Profits in the margin (£171,000 – £50,000)	121,000	× 26.5%	32,065
Profits below the lower limit	50,000	× 19%	9,500
Unrelieved QCDs	1,000	× 0%	0
	<hr/>		
	172,000		
Y/e 31 March 2025			
Profits above upper limit	98,000	× 25%	24,500
	<hr/>		
	270,000		
Total saving			<hr/> 66,065 <hr/>

This option would lead to no tax being due for the year ended 31 March 2024 (due 1 January 2025) and a reduction in tax due for year ended 31 March 2025 (due 1 January 2026).

(3) Current AP claim then carry back

A current AP claim must be made to set the loss against total profits before QCDs for the year ended 31 March 2024 (as above) before carrying the remaining loss of £98,000 back against total profits before QCDs for the year ended 31 March 2023.

The year ended 31 March 2023 falls into FY2022, where there was a single corporation tax rate of 19%.

The tax saving will be as follows:

	Loss used £	Effective rate	Tax saving £
Y/e 31 March 2024			
Profits in the margin (£171,000 – £50,000)	121,000	× 26.5%	32,065
Profits below the lower limit	50,000	× 19%	9,500
Unrelieved QCDs	1,000	× 0%	0
	<hr/>		
	172,000		
Y/e 31 March 2023			
All profits	98,000	× 19%	18,620
	<hr/>		
	270,000		
Total saving			<hr/>
			60,185

This option would lead to a repayment of part of the tax for year ended 31 March 2023 (assuming this has been paid) and no tax being due for the year ended 31 March 2024.

Conclusion

Option 1 gives the highest tax saving and does not result in any wasted QCDs. However, if the company's directors are concerned with cash flow, then they may prefer option 3 which gives a repayment of part of the tax for year ended 31 March 2023.



Test your understanding 2

Crocus Ltd has the following results

	y/e 31.3.24	y/e 31.3.25	y/e 31.3.26
	£	£	£
Trading profit/(loss)	170,000	(110,000)	360,000
Property income	4,000	4,500	5,000
Chargeable gain/(capital loss)	20,000	0	(15,000)
QCDs	(3,000)	(3,000)	(3,000)

The directors wish to relieve their losses as efficiently as possible.

Advise the directors which loss claim or combination of claims will achieve their objective and quantify the tax saving and any repayments due.

3 Restrictions on loss relief

You are expected to be aware of the following restrictions that may apply to loss relief.

Trade becomes small or negligible

If a company's trade becomes small or negligible in an accounting period in which it makes a trading loss, the loss can only be carried forward against **future trading profits from the same trade**, not against total profits.

If the trade ceases completely, it will not be possible to carry forward the loss.

Profits in excess of £5 million

The maximum profit of a company (or group) that can be relieved by carry forward of losses is restricted to an allowance of £5 million a year, plus 50% of remaining total profits after deduction of this allowance. This applies to all brought forward losses including brought forward capital losses.

There is only one £5 million allowance to cover both trading losses and capital losses.

The company (or group) can choose how to allocate the allowance between different loss types and/or different companies within the group.

In the ATX exam, you are only required to have an awareness of this restriction and will not be expected to apply it to a scenario.

Change in ownership

In order to prevent tax avoidance there are restrictions on the carry forward or carry back of trading losses when there is a change in the ownership of a company.



A change in ownership means that more than one half of the ordinary share capital of a company is acquired by a person or persons, ignoring any person acquiring 5% or less. A person could be an individual or a company.

For example, an individual shareholder owns 10% of a company's shares and purchases a further 60%, making a total holding of 70%. As more than half (in this case 60%) of the shares have changed hands, this is a change in ownership.

Restrictions

The restrictions apply in two situations:

- where there is **both** a **change in ownership** and a **major change** in the **nature or conduct of the trade** within a **five year period beginning no more than three years before** the change in ownership, or
- when **at any time** after the scale of **activities** of the trade has become **small or negligible**, and before any considerable revival of the trade, there is a change in the ownership of the company.



The restrictions prevent:

- losses from before the change in ownership being carried forward against profits arising after the change in ownership, and
- losses incurred after the change of ownership being carried back before the change of ownership.

Major change in the nature or conduct of the trade

It is important to understand that the trade itself has not changed, just the nature or conduct of trade. Major changes include:

- a major change in the type of property dealt in or services provided, and
- a major change in customers, outlets or markets.



Test your understanding 3

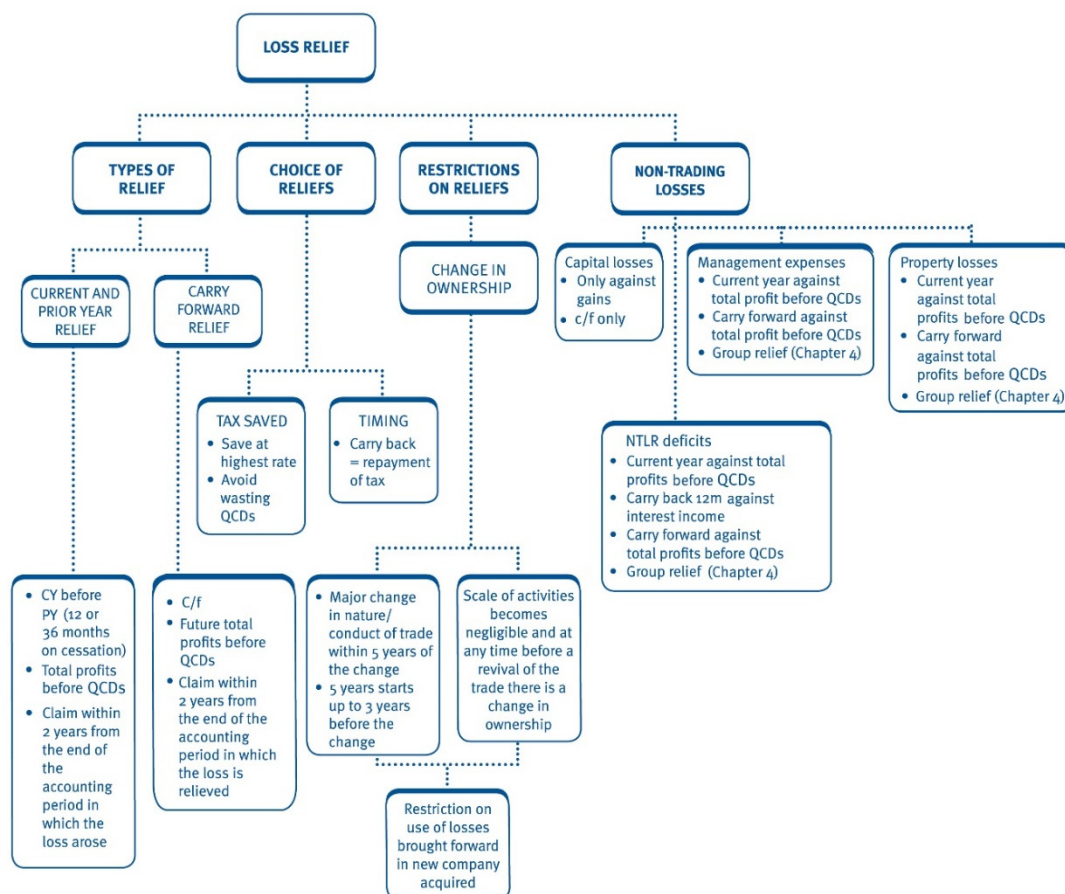
All the share capital of Halo Ltd has recently been acquired by Richard. Halo Ltd manufactures mobile phone accessories which it sells to large retailers. Halo Ltd has made heavy losses for the last two years.

Richard wants to make the following changes to the company over the next three years:

- Relocate most of the manufacturing activity overseas.
- Expand the company's product range.
- Start to sell direct to the public over the internet.
- Appoint two new sales directors.

State the effect these changes are likely to have on the company's corporation tax loss position.

4 Chapter summary



Test your understanding answers



Test your understanding 1

Lost Ltd

(a) Lost Ltd – Taxable total profits

	y/e 30.6.23 £	p/e 31.3.24 £	y/e 31.3.25 £
Trading profit	86,600	20,800	0
Property income	0	4,500	5,600
Net chargeable gain (£9,500 – £3,000)	0	0	6,500
Total profits	86,600	25,300	12,100
Less: Loss relief			
– Current year			(12,100)
– Carry back 12 mths	(21,650)	(25,300)	
	64,950	0	0
Less: QCDs	(1,400)	Wasted	Wasted
TTP	63,550	0	0

Loss working

	£
Trading loss y/e 31 March 2025	78,300
Less: Used in current year claim – y/e 31 March 2025	(12,100)
	66,200
Less: Used in 12 month carry back	
– 9 m/e 31 March 2024	(25,300)
	40,900
– y/e 30 June 2023: Maximum = $(3/12 \times £86,600)$	(21,650)
Loss remaining to carry forward	19,250

(b) If Lost Ltd ceased to trade on 31 March 2025

- Following a current year claim the trading loss of the final 12 months could be relieved against total profits for the previous 36 months.
- Therefore, the unrelieved losses of £19,250 could have been carried back and fully set off in the year ended 30 June 2023.



Test your understanding 2

Crocus Ltd

- The capital loss must be carried forward for offset against future chargeable gains. It may not be set against income and it cannot be carried back.
- Relieving losses as efficiently as possible means the trading loss must be relieved to save the maximum amount of tax. This means that, where possible, the loss should be relieved against profits taxed at the marginal rate.
- In the year ended 31 March 2025 the company is paying tax at the small profits rate of 19%. However, in the year ended 31 March 2024 marginal relief applies. In the year ended 31 March 2026 the company is paying tax at the main rate of 25% (W1).
- To relieve the marginal profits of the year ended 31 March 2024, the company must first claim against the profits of the year ended 31 March 2025.
- This uses £4,500 of the loss and wastes the QCD of £3,000, leaving £105,500 to be carried back.

The tax saving with current year and carry back claims is:

	Loss used £	Effective rate	Tax saving £
Y/e 31 March 2025			
Profits below the lower limit	1,500	× 19%	285
Unrelieved QCDs	3,000	× 0%	0
	<hr/> 4,500		
Y/e 31 March 2024			
Profits in the margin	105,500	× 26.5%	27,958
	<hr/> 110,000		
Total saving			<hr/> 28,243 <hr/>

- If all of the loss is carried forward, the saving is:

	Loss used £	Effective rate	Tax saving £
Y/e 31 March 2026			
Profits above the upper limit	110,000	× 25%	27,500
	<hr/> 110,000		
Total saving			<hr/> 27,500 <hr/>

- If a current year claim is made, but not the carry back claim, so that the remaining loss is carried forward, the saving is:

	Loss used £	Effective rate	Tax saving £
Y/e 31 March 2025			
Profits below the lower limit	1,500	× 19%	285
Unrelieved QCDs	3,000	× 0%	0
	<hr/> 4,500		
Y/e 31 March 2026			
Profits above upper limit	105,500	× 25%	26,375
	<hr/> 110,000		
Total saving			<hr/> 26,660 <hr/>

Conclusion

The directors should claim relief in the loss-making year and carry back the loss to the year ended 31 March 2024 as it gives the highest tax saving.

This also gives earliest relief and will lead to a repayment of tax for the year ended 31 March 2024 of £27,958 or (£46,865 (W1) – £18,907 (W2)).

Workings**(W1) Corporation tax payable before loss relief**

Year ended:	31.3.24	31.3.25	31.3.26
	£	£	£
Trading profit	170,000	0	360,000
Property income	4,000	4,500	5,000
Chargeable gain	20,000	0	0
	<hr/>	<hr/>	<hr/>
Total profits	194,000	4,500	365,000
Less: QCDs	(3,000)	(3,000)	(3,000)
	<hr/>	<hr/>	<hr/>
TTP	191,000	1,500	362,000
	<hr/>	<hr/>	<hr/>
Status	Marginal	Small	Main rate
	£	£	£
CT at 25%/19%/25%	47,750	285	90,500
Less: Marginal relief			
(£250,000 – £191,000) × 3/200	(885)		
	<hr/>	<hr/>	<hr/>
CT payable before relief	46,865	285	90,500
	<hr/>	<hr/>	<hr/>

(W2) Corporation tax payable after recommended claims

Year ended:	31.3.24	31.3.25	31.3.26
	£	£	£
Trading profit	170,000	0	360,000
Property income	4,000	4,500	5,000
Chargeable gain	20,000	0	0
	<hr/>	<hr/>	<hr/>
Total profits	194,000	4,500	365,000
Less: Loss relief	(105,500)	(4,500)	
Less: QCDs	(3,000)	Wasted	(3,000)
	<hr/>	<hr/>	<hr/>
TTP	85,500	0	362,000
	<hr/>	<hr/>	<hr/>
Status	Marginal		Main rate
	£	£	£
CT at 25%	21,375	0	90,500
Less: Marginal relief			
(£250,000 – £85,500) × 3/200	(2,468)		
	<hr/>	<hr/>	<hr/>
CT payable before relief	18,907	0	90,500
	<hr/>	<hr/>	<hr/>

**Test your understanding 3****Halo Ltd**

The changes that Richard proposes are likely to be taken by HMRC as a major change in the nature or conduct of Halo Ltd's trade.

As the changes occur within five years of Richard buying the company (a change in ownership) they will have the result of disallowing Halo Ltd's loss relief.

Losses will no longer be available to carry forward against profits arising after the change in ownership.

Groups and consortia

Chapter learning objectives

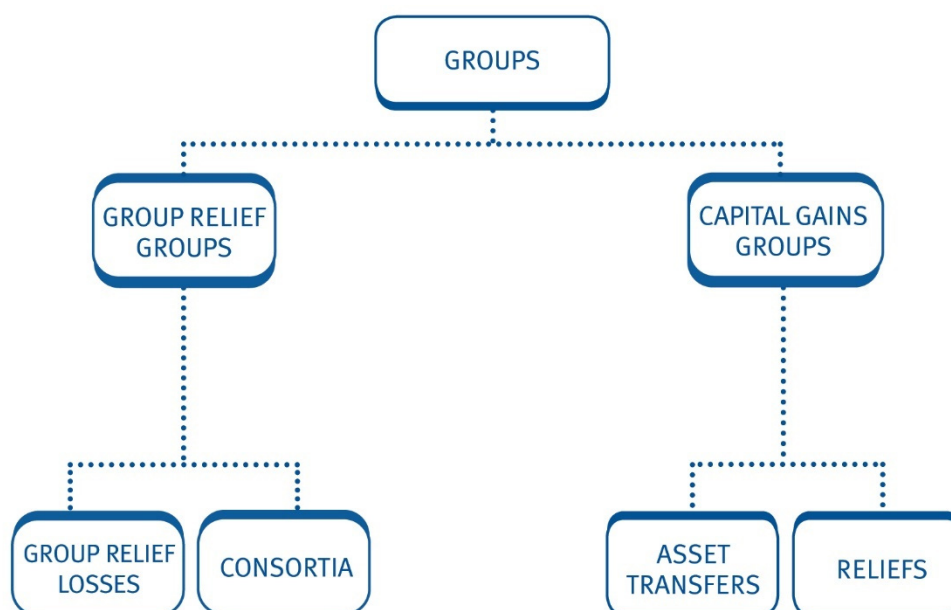
Upon completion of this chapter you will be able to:

- advise on the tax consequences of a transfer of intangible assets
- advise on the tax consequences of a transfer of a trade and assets where there is common control
- understand the meaning of consortium owned company and consortium member
- advise on the operation of consortium relief
- determine pre-entry losses and understand their tax treatment
- determine the degrouping charge where a company leaves a group within six years of receiving an asset by way of a no gain/no loss transfer
- determine the effects of the anti-avoidance provisions, where arrangements exist for a company to leave a group
- advise on the use of exemptions and reliefs in deferring and minimising stamp taxes: advise on group transactions
- identify and advise on the taxes applicable to a given course of action and their impact
- identify and understand that the alternative ways of achieving personal or business outcomes may lead to different tax consequences
- assess the tax advantages and disadvantages of alternative courses of action

- understand the statutory obligations imposed in a given situation, including any time limits for action and advising on the implications of non-compliance
- advise on legitimate tax planning measures, by which the tax liabilities arising from a particular situation or course of action can be mitigated
- advise on the appropriateness of such investment, expenditure or measures given a particular taxpayer's circumstances or stated objectives
- advise on the mitigation of tax in the manner recommended by reference to numerical analysis and/or reasoned argument



One of the PER performance objectives (PO17) is to advise on mitigating and deferring tax liabilities through legitimate tax planning measures. The reliefs available to groups are a key area you may need to advise on. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter deals with the tax position of groups of companies, where one company owns shares in another.

Remember that for corporation tax purposes:

- each company within the group is treated as a separate entity
- each company is required to submit its own individual tax return
- but being a member of a group provides opportunities for tax planning, to save tax and improve the cash flow of the group.



Much of this chapter is a revision of the rules covered in TX, however there is a much greater emphasis at ATX on tax planning aspects:

- choosing the most tax efficient group structure for the business
- effective use of loss reliefs
- effective crystallisation or deferral of chargeable gains, and
- giving tax advice on proposed strategies.



All of the above present opportunities for you to demonstrate your professional skills in the exam: in particular, your ability to analyse and evaluate complex information and to communicate advice clearly to your clients.

The new areas at ATX are:

- Consortium relief
- Degrouping charges
- Pre-entry capital losses
- Transfers of a trade and assets.

1 75% groups

Identification of 75% groups

The identification of the appropriate 75% groups for corporation tax purposes is essential before any tax planning advice can be given.

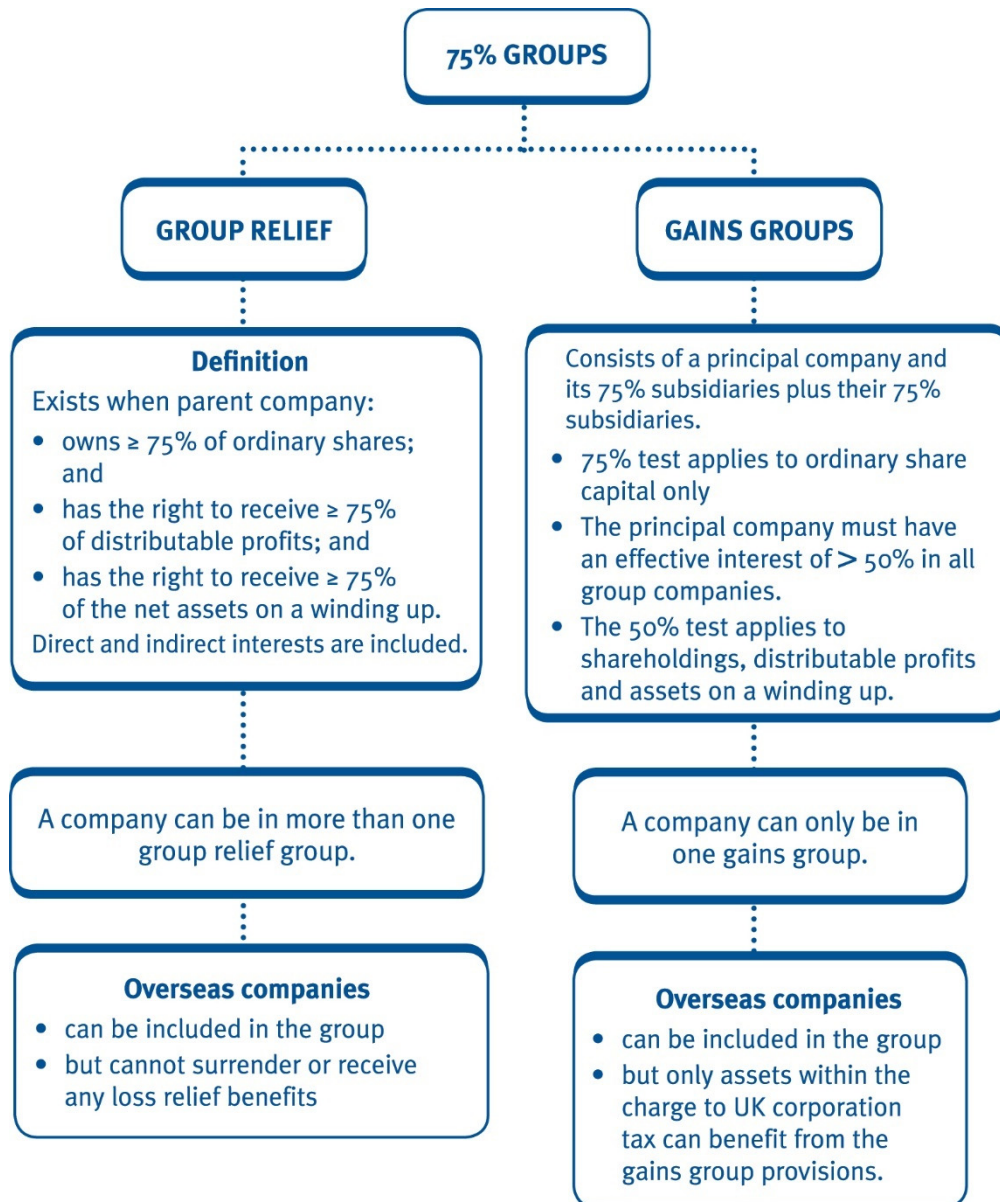
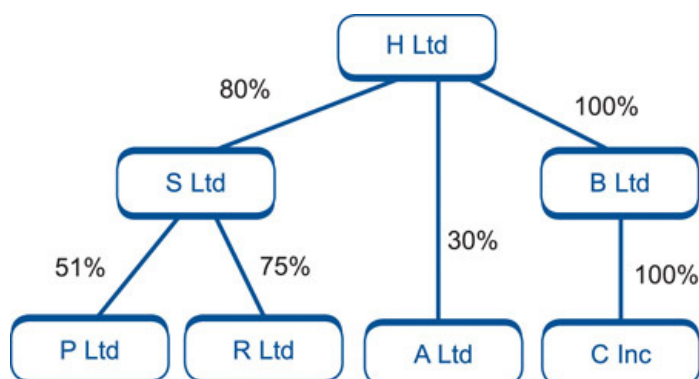




Illustration 1 – 75% groups



C Inc is resident overseas.

In the above group structure identify the 75% groups for loss relief and 75% gains groups.

Solution

(i) Groups for group loss relief

- Group 1: H Ltd, S Ltd, B Ltd and C Inc (although C Inc may not receive any loss relief).
- Group 2: S Ltd and R Ltd.

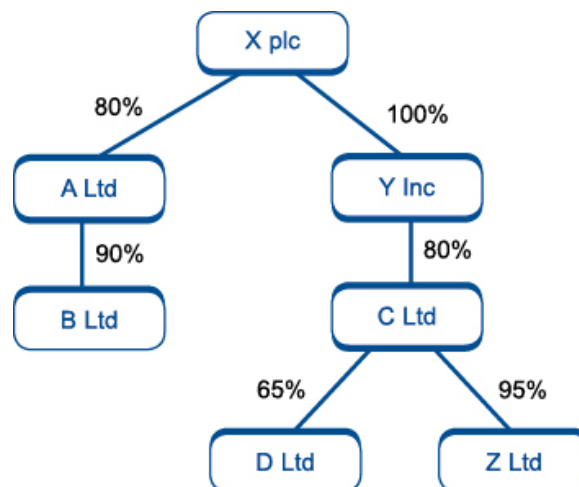
H Ltd has only a 60% ($80\% \times 75\%$) indirect interest in R Ltd and hence R Ltd cannot be in a group with H Ltd.

(ii) Capital gains group

R Ltd can be included in the main group which now consists of H Ltd, S Ltd, R Ltd, B Ltd and C Inc (although the reliefs only apply to assets within the charge to UK corporation tax).



Test your understanding 1



Y Inc is resident in Canada.

In the above group structure identify the 75% groups for loss relief and 75% gains groups.

2 Group relief



- Members of a group relief group may surrender losses to profitable group members to utilise against their own taxable total profits.
- Losses surrendered must be set against the claimant company's taxable total profits of a corresponding accounting period (see below).
- Rules apply to both the surrendering and the claimant companies as follows.



Surrendering company	Claimant company
<ul style="list-style-type: none"> • Can surrender current period: <ul style="list-style-type: none"> – trading losses – NTLR deficits (interest income) <p>does not have to make a claim against its own profits first.</p> <ul style="list-style-type: none"> – excess QCDs – excess management expenses of a company with investment business – excess property losses – excess non-trading IFA losses <p>only amounts in excess of total profits (before loss relief) can be surrendered.</p> • Can surrender brought forward: <ul style="list-style-type: none"> – trading losses – NTLR deficits (interest income) – management expenses of a company with investment business – property losses – non-trading IFA losses <p>to the extent that the surrendering company is unable to use the loss against its own total profits (although there is no requirement for the surrendering company to actually claim to relieve a brought forward loss against its own profits first).</p> • Can surrender to one or more companies within the group. • Can surrender any amount desired provided the claimant company can utilise the loss. 	<ul style="list-style-type: none"> • Offsets the surrendered loss against its TTP. • Cannot carry group relief forwards or backwards. • Can only claim sufficient to reduce its TTP to £Nil. • The maximum group relief claim is restricted to the claimant company's TTP, assuming that losses brought forward and current year losses are offset first and for the maximum amount. <p>This is regardless of the fact that the company may not actually make a claim to offset current year trading losses and the amount of a claim to offset brought forward losses may be made for a specified amount.</p>

- Group relief is claimed
 - by the **claimant company** on its corporation tax return
 - within **two years of the end of its AP**
 - but requires a notice of consent from the surrendering company.



Illustration 2 – Maximum group relief

Mountain Ltd owns 100% of the share capital of a number of profitable UK resident companies. All companies prepare accounts to 31 March.

Mountain Ltd's results for the year ended 31 March 2024 are as follows:

	£
Trading loss	(130,000)
Interest income	2,300
Property business loss	(15,000)
Qualifying charitable donations	(4,000)
Capital loss	(12,000)

In addition, Mountain Ltd has unrelieved trading losses brought forward at 1 April 2023 of £50,000.

What is the maximum amount of loss that Mountain Ltd can surrender to its 100% subsidiaries, using group relief, for the year to 31 March 2024?

Solution

The maximum amount of loss that Mountain Ltd can surrender using group relief is calculated as follows:

	£	£
Trading loss – current period		(130,000)
Excess property business loss and QCDs and trading loss b/f:		
Trading loss b/f	(50,000)	
Property business loss	(15,000)	
Qualifying charitable donations	(4,000)	
Less: Interest income	2,300	
	<u> </u>	(66,700)
Maximum group relief		<u>(196,700)</u>

- Current year losses can be surrendered in full.
- Only excess property business losses, QCDs and trading losses b/f can be surrendered. So these losses are reduced by the amount of other income, in this case interest income.
- Capital losses cannot be surrendered under the group relief provisions.

Corresponding accounting periods

Losses surrendered by group relief, must be set against the claimant company's profits of a 'corresponding' accounting period as follows:

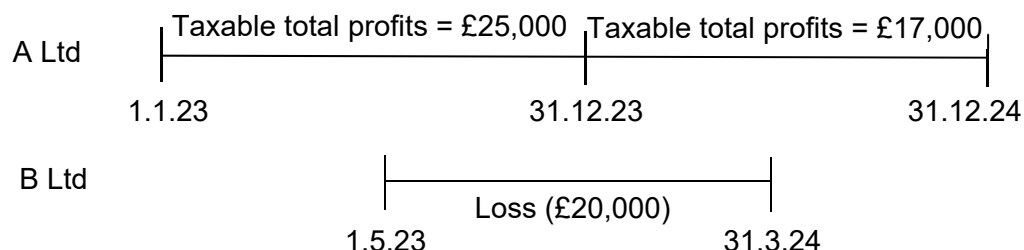
- A corresponding accounting period is any accounting period falling wholly or partly within the surrendering company's accounting period.
- Where the companies do not have coterminous (same) year ends, the available profits and losses must be time apportioned, to find the relevant amounts falling within the corresponding accounting period.
- In this situation, the maximum 'loss' that can be surrendered = lower of:

	£
(a) 'loss' (both current period and brought forward losses) in the surrendering (loss making) company for the corresponding accounting period, and	X
(b) 'taxable total profits' in the claimant company for the corresponding accounting period	X



Test your understanding 2

A Ltd and B Ltd are members of the same 75% loss relief group.



- (a) Calculate the maximum amount of loss that B Ltd can surrender to A Ltd for use in year ended 31 December 2023 and compute the revised taxable total profits of A Ltd assuming B Ltd surrenders the maximum amount of loss.
- (b) Calculate the maximum amount of loss that B Ltd can surrender to A Ltd for use in year ended 31 December 2024 and compute the revised taxable total profits of A Ltd assuming B Ltd surrenders the maximum amount of loss.



Test your understanding 3

Romeo Ltd owns 80% of the ordinary share capital of Juliet Ltd. These shares were acquired many years ago. Both companies are UK resident for tax purposes. Their most recent results have been:

	Romeo Ltd	Juliet Ltd
	12 m/e	9 m/e
	31.12.23	31.3.24
	£	£
Tax adjusted trading profit	890,000	
Tax adjusted trading losses		(77,000)
Capital gains		15,000
Bank interest receivable	6,000	4,000
Property income	2,000	8,000
Dividends from other UK companies		32,000
Dividend from Juliet Ltd	27,000	
Qualifying charitable donation	4,000	5,000

In addition, Juliet Ltd has unrelieved trading losses brought forward at 1 July 2023 of £52,000.

Compute the corporation tax payable by each company for the above accounting periods, on the assumption that maximum possible group relief is claimed by Romeo Ltd. Show the amount of unrelieved losses carried forward by Juliet Ltd, assuming any other beneficial claims are made.

Planning points

The following points should be considered, when deciding how to offset a trading loss which arises within a 75% group relief group company:

- Whether the loss should be surrendered.
- Order of surrender.

Choosing whether to surrender

A group member with a loss has the choice of:

- making a claim against its own profits, and/or
- surrendering some/all of the loss to another group member.

Remember that:

- Unlike utilising a company's own current year losses (which is '**all or nothing**'), group relief is very flexible.
- It is possible to specify the amount of loss to be surrendered within a group – which can be **any amount up to the maximum amount**.
- One of the key aims is to ensure losses are used within the group to save the most tax. Accordingly, losses are first set against profits taxed at the marginal rate.
- The surrendering company may surrender **some** of its losses using group relief and utilise the rest against its own profits.
- If it has paid QCDs, it should ensure that losses retained will reduce total profits before deduction of QCDs to the amount of any QCDs paid. This will allow the QCDs to be deducted in full without any corporation tax becoming due.
- If the surrendering company was profitable in the previous period, it may be beneficial to retain enough losses to make a carry back claim. The carry back claim will generate a refund of corporation tax already paid. However, in order to make a prior year claim, an 'all or nothing' current year claim must first be made, which may waste QCDs in the current year.
- As a current year claim against the company's own profits is 'all or nothing' it is important that the optimum group relief surrender is made first, leaving the desired amount of loss available against the company's own profits.

Payment for group relief

- It is usual, particularly where there is a minority shareholder, for the claimant company to pay for group relief. Such payments, subject to a maximum of £1 per £1 of loss claimed, are ignored for tax purposes.

3 Effect on group relief of changes in group structures



Companies joining a group

There are several areas to consider:

- A corresponding accounting period begins when a company joins a group and it may be necessary to time apportion available losses and profits for the overlapping period, as shown in section 2.
- Losses **arising in a subsidiary before it joins a group** are **not available** for surrender to companies within the new group for **five years**.
However, there is no such restriction on companies within the group surrendering brought forward losses to the new subsidiary.
- When a loss-making company joins a group there is a 'change in ownership' of that company, and consequently there may be a restriction on the use of its brought forward losses against its own profits if there is also a major change in the nature or conduct of trade (Chapter 3).

Companies leaving a group

Group relief ceases to be available once arrangements are in place to sell the shares of a company. This will usually occur sometime before the actual legal sale of the shares.

- HMRC considers that arrangements come into existence once there is agreement in principle between the parties that the transaction will proceed. This is so even though such agreement is still subject to contract and not finally binding on either party.
- HMRC will look at correspondence and details of the negotiations to determine the date of any arrangements coming into force.
- For computational examination questions you should be given the date on which a company is deemed to leave a group.

4 Losses of overseas companies

Group relief is normally only allowed between UK resident group companies.

There are some exceptions, but these are not examinable in the ATX examination.



5 Consortia

Introduction

Further loss relief is available if companies are structured as a consortium.

The tax reliefs available between qualifying companies where a consortium is involved are more limited than for a 75% loss group.

Definition of a consortium

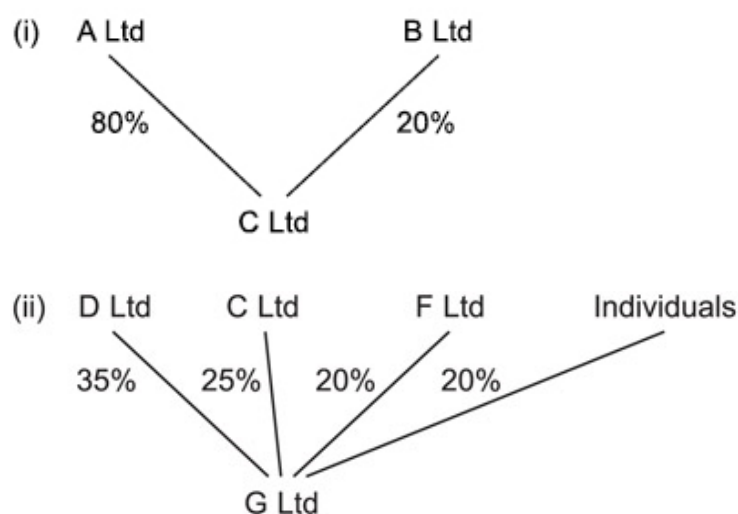


There are several elements to the definition:

- A consortium exists where two or more companies (UK or overseas) between them own at least 75% of another company.
- Each company must own at least 5% but less than 75%.
- Ownership includes ordinary shares and assets and profits as for a 75% group.
- The investing company is known as a consortium member.
- The target company is known as a consortium company.



Test your understanding 4



Explain whether the above structures are a consortium for tax purposes.



Effect of being in a consortium

Consortium relief (a form of loss relief) is available between a UK consortium company and its UK members, for current period and brought forward qualifying losses.

The same types of loss are available for consortium relief as were available for group relief in section 2. The same rules also apply with regards to the profits the claimant company can offset the losses against.

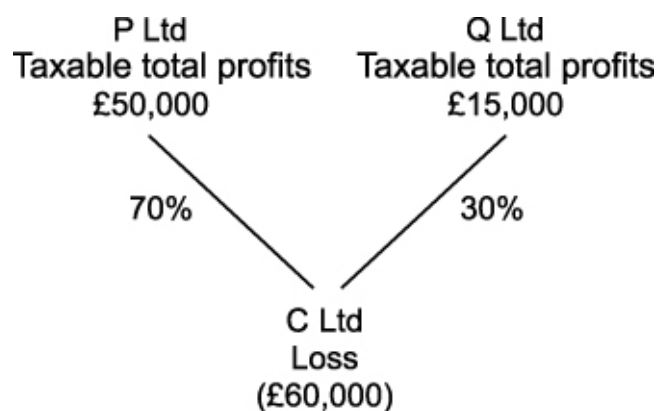
Corresponding accounting period rules apply as they do for group relief.

- Losses can be **surrendered upwards** from the consortium company to the consortium members:
 - But only up to the percentage interest that the consortium member has in the consortium company.
 - The loss must first be relieved against current period total profits before QCDs in the consortium company.
- Losses can also be **surrendered downwards** from consortium members to the consortium company to relieve
 - up to their percentage of the consortium company's TTP
 - the loss does not have to be relieved in the consortium members' computation first.

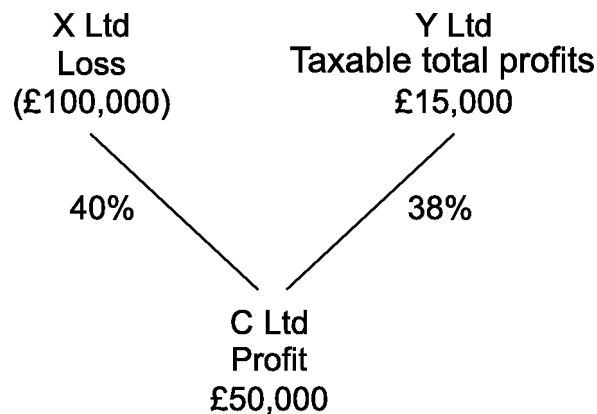
- The maximum consortium loss relief available for surrender is the lower of:
 - (i) the results of the consortium member
 - (ii) the consortium members' percentage entitlement to the results of the consortium company.
- Losses cannot be exchanged between consortium members.
- Consortium members can be resident anywhere in the world but only a UK resident consortium member can claim or surrender losses.



Test your understanding 5



Calculate the maximum consortium relief available for P Ltd and Q Ltd. Assume all companies have coterminous year end dates.



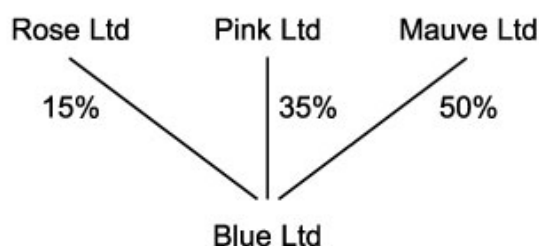
Explain how X Ltd can relieve its loss within the consortium. Assume all companies shown have coterminous year end dates.

As for group relief, consortium relief must be claimed:

- by the **claimant company** on its corporation tax return
- within **two years of the end of its AP**.



Test your understanding 6



In the year ended 31 March 2024 their results were:

		£
Rose Ltd	Trading loss	(90,000)
Pink Ltd	Trading loss	(126,000)
Mauve Ltd	Taxable total profit	55,000
Blue Ltd	Taxable total profit	300,000

None of the companies receive any dividends.

- (i) Calculate the corporation tax liabilities of all companies, on the assumption that the maximum amount of consortium relief is claimed.
- (ii) Explain how your answer would differ if Rose Ltd owned 80% of Blue Ltd, with Pink Ltd and Mauve Ltd owning 10% each. Do not recalculate the liabilities.

6 Capital gains groups

Introduction

There are various special tax rules to consider within a capital gains group:

- Transfer of assets within the group and subsequent disposal
- Degrouping charges for companies leaving a group
- Reallocation of gains or losses
- Rollover relief.

Transfer of assets

When an asset is sold to another gains group member:

- this is a **no gain/no loss** transfer (regardless of any actual price paid)
- the receiving company acquires the asset at a base cost equal to its original cost plus indexation up to the point of transfer (or December 2017, if earlier)
- this treatment is **automatic**; no election is needed.

No gain arises until either:

- the receiving company sells the asset outside the group, or
- the group company receiving the asset leaves the group (degrouching charge).

Disposals of assets outside the group

A normal capital gain or loss is calculated.



Test your understanding 7

Green Ltd acquired a building on 1 April 1997, for £100,000. The building was transferred to Jade Ltd, a wholly owned subsidiary, on 1 October 2007, for £120,000, when it was worth £180,000.

On 1 December 2023, Jade Ltd sold the building outside of the group for £350,000.

Calculate any chargeable gains arising on the disposals.

Assume the indexation factors are as follows:

April 1997 to October 2007	0.337
April 1997 to December 2017	0.779
October 2007 to December 2017	0.331

Structures and buildings allowances (SBAs)

If an asset on which SBAs have been claimed is transferred within a gains group:

- The **transferor** does **not** need to add SBAs claimed to its disposal proceeds.
- The **receiving** company
 - is treated as if it always owned the asset, and
 - will claim SBAs based on the original cost.
- When the receiving company subsequently disposes of the asset
 - **all SBAs** claimed to date (by both the transferor and transferee) will be added to the disposal proceeds in the chargeable gain calculation.



Degrouping charge



A degrouping charge arises when a group company:

- leaves a group
- still owning an asset that it had received via a no gain/no loss transfer from a fellow group company
- within the last **six years**.

Calculation of degrouping charge

- The company leaving the group is deemed to have:
 - sold and repurchased any assets acquired from other group members
 - at their MV on the day of intra-group transfer (not the MV when it leaves the group).
- | | |
|--|-------|
| | £ |
| Proceeds (MV at date of intra-group transfer) | X |
| Less: Cost to group | (X) |
| Less: Indexation to date of intra-group transfer
(or December 2017, if earlier) | (X) |
| | X/(X) |
- The degrouping charge is added to the consideration received by the vendor company selling the shares in the company leaving the group.
Note that if there is a degrouping loss, this is deducted from the consideration.
 - This additional consideration is unlikely to be taxable:
 - as the company selling the shares is likely to benefit from the substantial shareholding exemption (SSE)
 - in respect of any gain or loss on disposal of the shares, including the degrouping charge.
 - If not covered by SSE:
 - the company can elect to reallocate the gain to another group member in the original group (see later)
 - however group rollover relief is not available for a gain on shares (as shares are not qualifying assets).

Other points

Stamp taxes

- There is no charge to stamp duty or stamp duty land tax (SDLT) where assets are transferred between two 75% group companies.
- This relief is not available where, at the time the assets are transferred, arrangements exist for the purchasing company to leave the group.
- If the transferee company leaves the group within **three years** of the original transfer:
 - the original exemption for SDLT is withdrawn, with duty becoming payable.

Intangible assets

Intangible assets, such as goodwill, fall outside the capital gains regime (see Chapter 2).

However, various reliefs which apply to capital gains groups are mirrored in the rules for intangible assets held within groups.

- Transfers of intangible assets between companies within gains groups are made on a 'tax neutral' basis.

This means that the acquiring company is treated as if it has always owned the asset and takes it over at its tax written down value (TWDV = cost less any amounts deducted).

- A charge similar to a degrouping charge arises if the group company receiving the asset leaves the group:

- **still owning an intangible asset** acquired
- in the previous **six years** from another group company.

This charge arises in the company leaving the group, although it can be reallocated within the old capital gains group.

However, the above charge will not arise where a company leaves a group as a result of a share disposal which is covered by SSE.

In this case the assets in question will remain at their TWDV and continue to attract relief as they did before the degrouping.



Illustration 3 – Degrouping charge

Shelley plc bought a freehold office block on 15 May 2000 for £350,000. On 10 June 2018 Shelley plc sold the office block to its wholly owned subsidiary Wordsworth Ltd, for £400,000 when the true market value of the office block was £620,000.

On 1 March 2024 Wordsworth Ltd sold the office block for £800,000.

Both companies prepare financial statements to 31 March each year.

- Calculate the gain realised by Wordsworth Ltd in March 2024.**
- Rather than have Wordsworth Ltd sell its office block, Shelley plc sells its entire shareholding in Wordsworth Ltd for £5 million on 1 March 2024. Advise the group of the gains (if any) that will arise as a result of this sale and any reliefs available.**

Assume the following indexation factor:

May 2000 to December 2017

0.629

Solution**Intra-group transfer: nil gain/nil loss**

	£
Cost	350,000
Plus: IA (May 2000 to December 2017)	
$0.629 \times £350,000$	220,150
	<hr/>
Base cost to Wordsworth Ltd	570,150
	<hr/>

Sale of asset outside the group

	£
Proceeds	800,000
Less: Base Cost	(570,150)
	<hr/>
Chargeable gain	229,850
	<hr/>

Note: IA stops at December 2017, so no further indexation applies.

Sale of Wordsworth Ltd

- Degrouping charge arises.
- Wordsworth Ltd is treated as if it had sold the building on 10 June 2018 at its MV, and then immediately reacquired it.

	£
Proceeds	620,000
Less: Base cost to Wordsworth Ltd (as above)	(570,150)
	<hr/>
Degrouping charge	49,850
	<hr/>

- The degrouping charge is added to the £5 million proceeds on the sale of the shares in Wordsworth Ltd.
- However any gain is likely to be exempt under the substantial shareholding rules as Shelley plc has owned 10% of the shares for 12 months out of the previous six years.
- SDLT would not have been charged when the office block was sold between the group companies.
- It is not charged retrospectively when Wordsworth Ltd leaves the group as this is more than three years after the original transfer.



Test your understanding 8

Yellow Ltd sold its wholly owned subsidiary, Orange Ltd, on 15 April 2023. Yellow Ltd had purchased a building on 1 August 2000 for £180,000. On 1 December 2018, the building was transferred to Orange Ltd for £230,000. Its market value on the date of the transfer was £375,000. Orange Ltd still owned the building on 15 April 2023.

Both companies prepare accounts to 31 March each year.

Explain the tax implications of the sale of Orange Ltd.

Assume the following indexation factor:

August 2000 to December 2017

0.631

Reallocation of gains or losses



Companies within a gains group can make a joint election to reallocate chargeable gains/allowable losses between group companies.

This election allows groups to achieve the following:

- Chargeable gains and allowable capital losses can be matched together within one company.
- Gains can be transferred to the group company/companies with capital losses brought forward (but beware of the restrictions on pre-entry capital losses).
- Gains can be transferred to the group company/companies paying the lowest rate of corporation tax.

The joint election:

- is available provided both companies are members of the gains group at the time the gain or loss arose
- must be made within two years of the end of the accounting period of disposal outside of the group
- must specify which company in the group is to be treated as having disposed of the asset.



Remember that only **current year** chargeable gains or allowable losses can be transferred (not brought forward capital losses).

Benefits of the joint transfer election

- As no actual transfer of assets is taking place within the gains group, there will be savings in legal and administrative costs.
- The two year time limit for making the election, means that tax planning can be undertaken retrospectively.
- An election can specify the amount of gain or loss to be transferred (i.e. it does not need to be the whole chargeable gain/allowable loss arising on a disposal). This gives increased flexibility with tax planning.



Test your understanding 9

During the year ended 31 March 2024 Violet Ltd is to dispose of a factory that will result in a capital loss of £75,000. Mauve Ltd, a 100% subsidiary of Violet Ltd, is to dispose of a warehouse that will result in a capital gain of £100,000.

The results of Mauve Ltd and Violet Ltd for the y/e 31 March 2024 are:

	Mauve Ltd	Violet Ltd
Trading profits	£10,000	£250,000

Show the taxable total profits for the year ended 31 March 2024 for each group company assuming the group wants to minimise the corporation tax of the group as a whole.

Group rollover relief

For the purposes of rollover relief, the gains group is treated as a single trade.

This means that a gain on the disposal of a qualifying asset in one group company can be rolled over against the purchase of qualifying assets, within the permitted time period, by another group company.



7 Complex group planning

Approach to a complex group losses question

Where there are qualifying losses for group relief, they need to be allocated for the benefit of the **group** as a whole (i.e. to save as much tax as possible).

The approach (as a general rule) to complex group questions should be:

- (i) Prepare a diagram of the group structure.
- (ii) Determine the 75% group(s) and consortia.
- (iii) Set up a tabular pro forma for TTP.

May need to calculate gains, consider ROR and reallocation of gains in a gains group to calculate TTP. Do this before dealing with losses.

- (iv) Complete the computations down to TTP, separating out any losses to loss workings.
- (v) Determine the best use of any qualifying losses.
- (vi) Where there are a number of losses in a question, deal with the losses with the most restricted set off first.
- (vii) Compute CT liability on revised TTP.
- (viii) Show CT payable and any losses or surpluses to be carried forward.

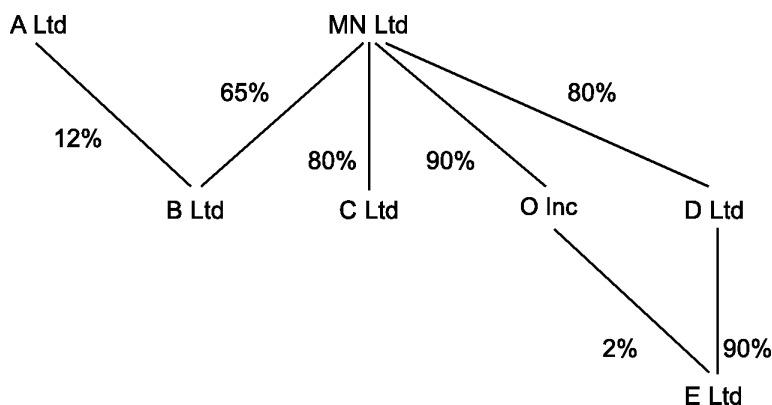
Factors to consider:

- Tax rates.
- Cash flow.
- Wastage of QCDs.



Illustration 4 – Complex group losses

The MN Group has the following structure:



O Inc is resident overseas. All other companies are UK resident.

No company had any other source of income or gains.

The trading results for the y/e 31 March 2024 were as follows:

	£
A Ltd	(60,000)
B Ltd	58,000
MN Ltd	53,000
C Ltd	(10,000)
D Ltd	293,000
E Ltd	(300,000)
O Inc	(12,000)

Assuming the maximum possible relief is claimed for the above losses, compute the corporation tax payable by each of the above companies for the 12 months ended 31 March 2024.

Solution**Corporation tax computations – Year ended 31 March 2024**

	A Ltd	B Ltd	MN Ltd	C Ltd	D Ltd	E Ltd
	£	£	£	£	£	£
Trading profits	0	58,000	53,000	0	293,000	0
Consortium relief (W3)		(6,960)				
Group relief						
E Ltd to D Ltd					(293,000)	
C Ltd to MN Ltd			(10,000)			
TTP	0	51,040	43,000	0	0	0
Corporation tax @ 25%	0	12,760	10,750	0	0	0

Generally, claims should be made within two years of the end of the AP of claim (i.e. by 31 March 2026).

Workings**(W1) Analysis of group structure**

Associated companies = MN Ltd, B Ltd, C Ltd, D Ltd, O Inc, E Ltd

Limits divided by 6 = $\text{£}250,000/6 = \text{£}41,667$
 $\text{£}50,000/6 = \text{£}8,333$

75% Groups

Group 1 = MN Ltd, C Ltd, D Ltd, O Inc (but O Inc resident overseas, therefore no loss relief)

Group 2 = D Ltd, E Ltd

Consortium

Members = A Ltd, MN Ltd

Consortium company = B Ltd

(W2) Loss working

	A Ltd	C Ltd	E Ltd
	£	£	£
Loss	60,000	10,000	300,000
Group relief			
– to D Ltd			(293,000)
– to MN Ltd		(10,000)	
Consortium relief (W3)	(6,960)		
	<hr/>	<hr/>	<hr/>
Loss to c/f	53,040	0	7,000
	<hr/>	<hr/>	<hr/>

O Inc is an overseas company, therefore its loss cannot be surrendered.

E Ltd can only surrender its loss to D Ltd.

A Ltd can only surrender its loss to B Ltd as consortium relief. The surrender is restricted to A Ltd's share of B Ltd's TTP.

C Ltd's loss can be surrendered to MN Ltd or D Ltd.

D Ltd has no profits remaining after claiming losses from E Ltd. Therefore, losses should be surrendered to MN Ltd.

(W3) Consortium relief to B Ltd

Lower of:	£
A Ltd's loss	60,000
% of B's TTP ($12\% \times £58,000$)	6,960

8 Comprehensive example**Test your understanding 10**

Anvil Ltd owns the following shares:

- 80% of the shares in Bench Ltd, which itself owns 80% of the shares in Chair Ltd
- 90% of the shares in Desk Ltd, and
- 60% of the shares in Fork Ltd.

Desk Ltd acquired 90% of the shares in Easel Ltd on 1 January 2024. All other shares are held by individuals.

The companies have the following tax adjusted results for the year ended 31 March 2024:

	Anvil Ltd	Bench Ltd	Chair Ltd	Desk Ltd	Easel Ltd	Fork Ltd
	£	£	£	£	£	£
Trading profit/loss	500,000	0	0	(130,000)	0	(50,000)
Interest income	0	35,000	0	30,000	160,000	0
Chargeable gain/loss	(10,000)	0	17,000	0	0	0

In addition to the above, Easel Ltd also has a trading loss brought forward of £20,000.

No company had any other source of income or gains.

- (a) (i) **Explain the group relationship that must exist for trading losses to be surrendered between group companies. Distinguish this from the relationship that must exist for chargeable assets to be transferred between two companies in a group without incurring a chargeable gain or an allowable loss. Identify which of the above companies are associated, which companies form a losses group and which companies form a gains group.**
- (ii) **Explain the factors that should be taken into account by the Anvil Ltd group when deciding how to use the trading losses within the group.**
- (b) (i) **Calculate the taxable total profits for each of the companies in the Anvil Ltd group for the year ended 31 March 2024 assuming that reliefs are claimed as efficiently as possible.**
- (ii) **Explain why you have chosen the reliefs as applied above in (b)(i), and explain how any unrelieved amounts may be used.**



9 Restrictions on company joining a gains group

Pre-entry capital losses

The rules on pre-entry capital losses (PECL) are designed to prevent a group from purchasing a company in order to use its capital losses incurred in the period before it joins a gains group, via a no gain/no loss transfer.

Where a company joins a gains group it must identify its capital losses at the point of entry.



Pre-entry capital losses are **realised losses only**.

(i.e. losses **already crystallised** on **disposals made** by the company **before it joined the gains group**).

Unrealised capital losses are not pre-entry capital losses (i.e. any losses that result from the sale of capital assets owned when the company joined the group but sold after joining are not subject to the following restrictions).

Using the loss



Pre-entry capital losses can only be used by the company that joins the group.

It can use them to relieve chargeable gains on assets:

- sold before joining the group (but in the same AP as the loss)
- owned when joining the group and sold later
- bought after joining the group from third parties (i.e. not other group members) and used in its own business.

Restriction on trading losses carried forward

If a company joining a gains group has trading losses carried forward, these can usually be set off against that company's future total profits, including gains (unless there is also a major change in the nature or conduct of trade – see Chapter 3).

However, if the company:

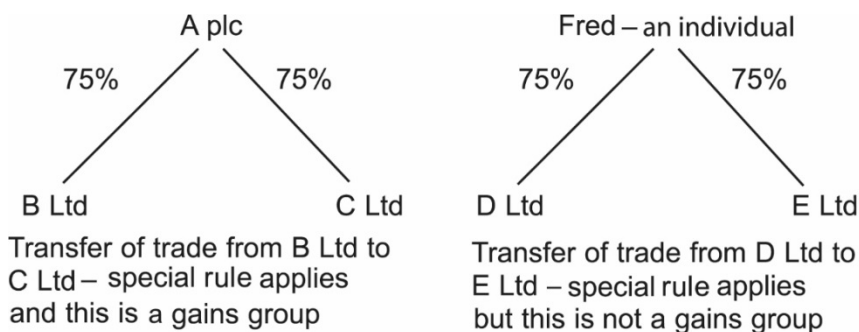
- receives a gain from the new group, or
- makes a gain on an asset transferred from the new group
- within five years of the date of changing owners (i.e. joining the group)

then any trading loss that arose before it joined the group **cannot** be set against this gain. This includes losses carried forward at the date of change in ownership in other companies within the new group, which **cannot** be group relieved against this gain.

10 Transfer of trade within a 75% group

Special reliefs apply when a company sells its trade and assets to another company that is under 75% common control.

Transfers between gains group members will meet this condition, as will transfers between companies with the same shareholders as follows:



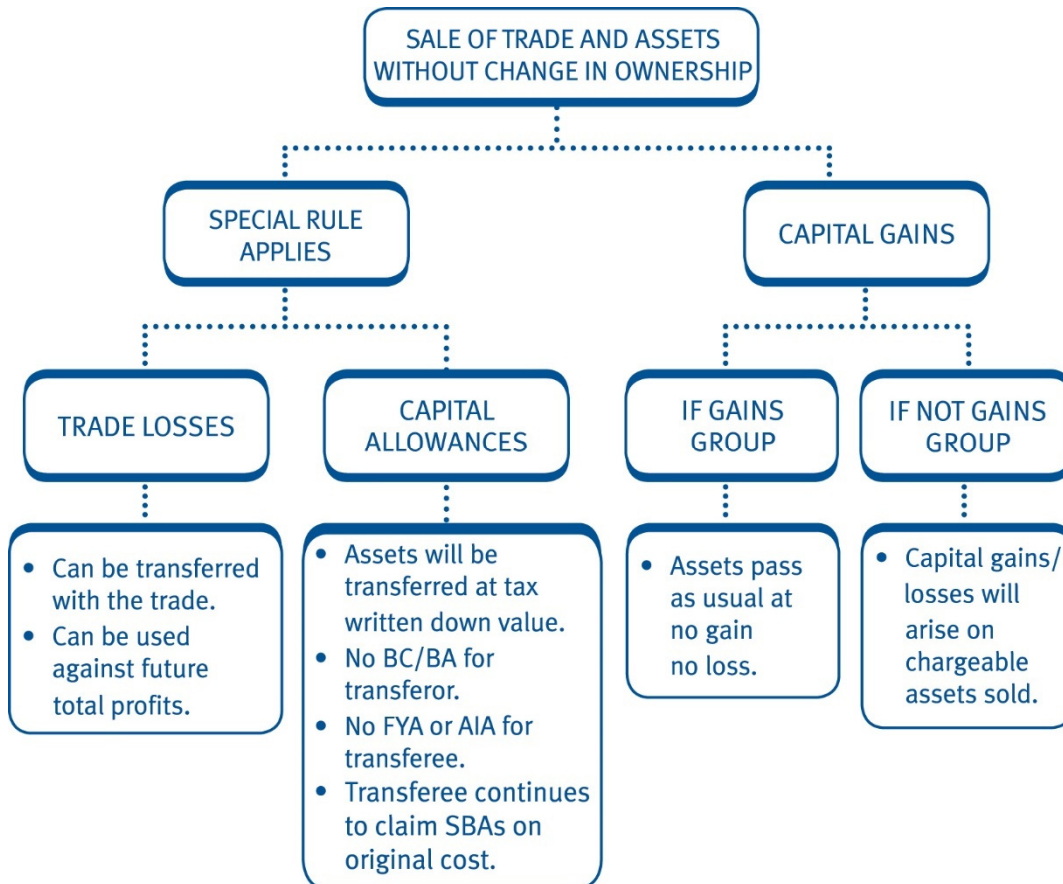
The same person or persons must have owned at least 75% of the trade:

- at some time within one year before the transfer of the trade, and
- at any time within two years after that transfer.

Normally when the trade and assets of a company are transferred to another company:

- any losses remain with the original company
- assets are transferred at market value, therefore:
 - balancing adjustments arise for capital allowances
 - capital gains arise.

However, if the special rule applies, the following reliefs apply:



It may be that a company wishes to separate a particular business by transferring it to a newly created subsidiary company. This is often referred to as a '**hive down**'.

Note that although the holding company of the new subsidiary will not have owned the shareholding in the new company for at least 12 months of the previous six years:

- the substantial shareholding exemption (SSE) will be available on the sale of the shares in the new subsidiary.
- as long as the assets owned by the new subsidiary have been used within a trade carried on by the group for at least the most recent 12 months.

In such a situation the above tax reliefs will also be available if all relevant conditions are satisfied.



11 Reconstructions and reorganisations

The term reconstruction is used to describe a number of situations. In general terms these are transactions in which:

- one company takes over another company, or
- one company takes over the business of another company.

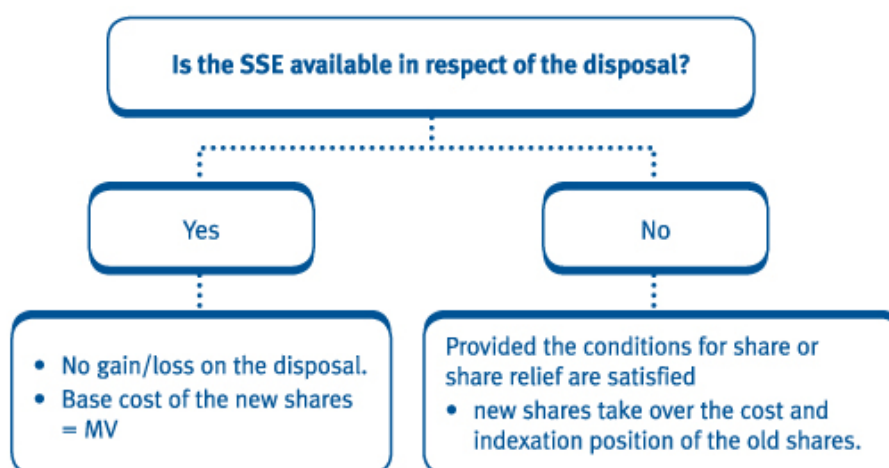
However, because shares or loan notes are issued to the original shareholders they retain an interest in the company or its business.



Share for share exchange

When an individual shareholder receives new shares in exchange for existing shares, then share for share exchange rules apply (Chapter 8).

The rules for companies are the same as for individuals except where the substantial shareholding exemption (SSE) rules apply.



Sale of shares or assets

A group may also choose to reorganise its business by selling its shares in a subsidiary, or simply by selling the trade and assets of the subsidiary, to a third party.

The main implications of company A selling its shares in company B as opposed to company B selling its trade and assets are summarised in the following tables:

	Sale of shares	Sale of trade and assets
Chargeable gains	<ul style="list-style-type: none"> • Chargeable gain/capital loss on the disposal of shares in the company <ul style="list-style-type: none"> – but ignore if SSE applies (gain = exempt loss = not allowable) 	<ul style="list-style-type: none"> • Chargeable gain/allowable capital loss arises on disposal of every single chargeable asset in the business <ul style="list-style-type: none"> – e.g. land and buildings, investments etc. – but not cars, P&M with value and cost ≤ £6,000, net current assets – ROR may be available • Taxable trading profit/allowable trading expense on disposal of intangible assets <ul style="list-style-type: none"> – e.g. goodwill, licences, franchises etc., (except loss on disposal of goodwill = non-trading debit) – Intangible ROR may be available
Stamp Duty	<ul style="list-style-type: none"> • Stamp duty payable at 0.5% by purchaser of shares (Chapter 8) 	<ul style="list-style-type: none"> • Stamp duty land tax payable by purchaser of land and buildings (Chapter 6)
Number of associated companies	<ul style="list-style-type: none"> • Company leaving group <ul style="list-style-type: none"> – associated for whole of AP when leaves group and associated with companies in new group – decrease in number of associated companies in old group next AP 	<ul style="list-style-type: none"> • Company does not leave the group <ul style="list-style-type: none"> – associated for whole of AP – but if a company sells its only trade = will become dormant – decrease in number of associated companies in old group next AP

	Sale of shares	Sale of trade and assets
Degrouping charge?	<ul style="list-style-type: none"> • Degrouping charge arises if the company leaving the group <ul style="list-style-type: none"> – is in a capital gains group, and – received an asset via a NGNL transfer – in the six years prior to leaving the group – added to sale proceeds received on disposal of shares and increases gain on those share – but ignore if SSE applies 	<ul style="list-style-type: none"> • No degrouping charge <ul style="list-style-type: none"> – only arises on the sale of shares in a company NOT on the sale of trade and assets
Value of assets transferred	<ul style="list-style-type: none"> • Assets transferred with the company at TWDV <ul style="list-style-type: none"> – no balancing charges or balancing allowances arise – capital allowances continue to be claimed by the company on TWDV in future – SBA continues to be claimed by the company on the original cost, and – base cost of assets for chargeable gain purposes = unchanged 	<ul style="list-style-type: none"> • Assets transferred to new group company at market value <ul style="list-style-type: none"> – balancing charges and balancing allowances arise in old company (none for SBA) – capital allowances to be claimed by new group company on MV – SBA to be claimed on the original qualifying costs (not MV) over the remaining useful life, and – base cost of assets for chargeable gain purposes = MV
AP	<ul style="list-style-type: none"> • AP unchanged 	<ul style="list-style-type: none"> • If company sells its only trade <ul style="list-style-type: none"> – it will cease to trade and AP will end
VAT	<ul style="list-style-type: none"> • No VAT arises on the sale of shares <ul style="list-style-type: none"> – outside the scope of VAT 	<ul style="list-style-type: none"> • For VAT – transfer as a going concern rules will probably apply (Chapter 26) <ul style="list-style-type: none"> – not a taxable supply – no VAT arises on sale – unless transfer land and buildings on which there is an option to tax

	Sale of shares	Sale of trade and assets
Losses	<ul style="list-style-type: none"> • If company leaving group = loss making <ul style="list-style-type: none"> – time apportion trading losses for AP <ul style="list-style-type: none"> – group relief possible to old group up to the date an arrangement is in place to sell the company – no group relief from date of arrangement to date of actual sale – group relief possible to new group from date of change in ownership – normal loss relief within the company itself available throughout – trading losses b/f that go with the company <ul style="list-style-type: none"> – can be used by that company in the future – but watch out for major change in nature or conduct of trade within five years starting up to three years before the change in ownership – trading losses b/f cannot be group relieved for five years following change in ownership 	<ul style="list-style-type: none"> • If company whose trade and assets are sold = loss-making <ul style="list-style-type: none"> – trading losses stay with the old company <ul style="list-style-type: none"> – not transferred to the new group company – trading losses have limited use: <ul style="list-style-type: none"> – possible claims: <ul style="list-style-type: none"> current period claim against total profits before QCD relief group relief to old group – remaining loss = useless as cannot c/f losses if the company ceases to trade – if sells its only trade and ceases to trade: <ul style="list-style-type: none"> – terminal loss carry back for three years against total profits before QCD relief

Sale of shares		Sale of trade and assets	
Advantages	Disadvantages	Advantages	Disadvantages
<ul style="list-style-type: none"> • No tax on disposal if SSE applies • No BAs or BCs arise • Loss relief goes with the company to the new group 	<ul style="list-style-type: none"> • All of the company is transferred <ul style="list-style-type: none"> – assets and liabilities 	<ul style="list-style-type: none"> • Can transfer just the assets the purchaser wants 	<ul style="list-style-type: none"> • Gains = taxable (may be deferred but not exempt) • BAs and BCs arise • Losses do not go to the new group



Illustration 5 – Sale of a company

X Ltd has been a 100% subsidiary of Y plc for many years. To streamline its businesses, Y plc wants to sell X Ltd and is considering either selling the shares or the trade and the assets on 1 April 2024 to Z plc.

X Ltd has some losses brought forward from previous years:

Trading losses	(£225,000)
Capital losses	(£50,000)

Y plc is confident that X Ltd will be profitable again in future.

The main asset owned by X Ltd is a ten-year-old office, purchased from Y plc for its market value of £160,000 on 1 June 2021. The office is currently worth £300,000, and originally cost Y plc £100,000.

X Ltd and Y plc prepare accounts to 31 December each year and both companies are trading.

(a) **Set out the key tax implications of a:**

- (i) **sale of the shares in X Ltd**
- (ii) **sale of the trade and assets of X Ltd.**

(b) **Explain the tax implications and benefits to a potential purchaser of transferring the trade and assets of X Ltd to a newly formed subsidiary, Newco Ltd, (a hive down) followed by the sale of Newco Ltd to the purchaser.**

You should ignore indexation allowance.

Solution

(a) (i) **Sale of shares in X Ltd**

Y plc

There will be no chargeable gain on the disposal of the shares in X Ltd as the substantial shareholding exemption (SSE) will apply. Y plc has held 10% of the X Ltd shares for at least 12 months out of the previous six years, and X Ltd is trading.

There will be a degrouping charge, as X Ltd will be leaving the Y plc group less than six years after the no gain, no loss transfer of the office building, with the asset.

Ignoring indexation allowance, the degrouping charge will be the market value of the office on 1 June 2021 of £160,000 less the original cost to the group of £100,000, giving a charge of £60,000.

However, this degrouping charge will be added to the proceeds for the sale of shares by Y plc and will be covered by the SSE.

X Ltd

X Ltd will continue to trade as before, and will continue to carry its trading and capital losses forwards.

However, as X Ltd will change its owners, if there is a major change in the nature or conduct of its trade within five years (beginning no more than three years prior to the change in ownership), the trading losses will not be available to set against future profits after 1 April 2024.

The capital losses will be pre-entry capital losses. These capital losses will only be available for use in X Ltd and cannot be set against gains from the sale of existing Z plc (or its group) assets.

Any plant and machinery will remain in X Ltd at its TWDV, and capital allowances will be unaffected by the change in ownership.

The base cost of the office building within X Ltd will be its market value on 1 June 2021 of £160,000.

There will not be any SBA implications given the age of the building.

X Ltd will still be an associated company of Y plc in the year ended 31 December 2024, and will also be associated with Z plc and its associates (if any).

Z plc

Z plc will pay stamp duty at 0.5% on the purchase of the shares in X Ltd.

As Z plc is purchasing an existing company, it may be exposed to contingent liabilities arising from events taking place prior to 1 April 2024.

(ii) Sale of trade and assets of X Ltd

X Ltd will have a chargeable gain on the disposal of the office. Ignoring indexation allowance, this gain will be the current value of £300,000 less the original cost to the group of £100,000, giving a gain of £200,000. The capital losses of £50,000 can be set against this gain. This will still leave £150,000 as a taxable gain in X Ltd which can be offset by the brought forward trading losses.

If X Ltd has any plant and machinery, balancing allowances or charges may arise on disposal. The remaining trading loss brought forward (£225,000 – £150,000 = £75,000) could be set off against any balancing charge.

After the sale, X Ltd will cease trading, and any unused trading losses will be wasted.

X Ltd will still be an associated company of Y plc in the year ended 31 December 2024, but will then be a dormant company in the following year and will no longer be counted as an associate.

There will be no VAT on the sale, assuming that the business is transferred as a going concern and Z plc is VAT registered, unless X Ltd has opted to tax the office building (Chapter 26).

Z plc

Z plc must pay stamp duty land tax (SDLT) (see Chapter 6) of £4,500 (W) on the purchase of the office building.

The base cost of the office for future disposals will be £300,000, as at 1 April 2024, giving a smaller gain on a future sale than if Z plc buys the shares in X Ltd.

If Z plc acquires plant and machinery from X Ltd, capital allowances (including the AIA) will be available based on the market value at 1 April 2024. This will give higher allowances for Z plc than if the shares in X Ltd are purchased.

Z plc will not acquire any losses, as these remain within X Ltd.

Working: Stamp duty land tax

£		£
150,000	× 0%	0
100,000	× 2%	2,000
50,000	× 5%	2,500
<hr/>		<hr/>
300,000		4,500
<hr/>		<hr/>

(b) Hive down**X Ltd**

The transfer of trade and assets to Newco Ltd will be a no gain, no loss transfer.

As Newco Ltd and X Ltd are under the same 75% ownership, the trading losses of £225,000 will be transferred with the trade, and any plant and machinery will be transferred at TWDV.

The capital loss brought forward will remain in X Ltd.

There will be no SDLT at the time of the transfer, but SDLT will be charged when Newco Ltd leaves the group within less than three years.

There will be no gain on the sale of the shares in Newco Ltd. The SSE will apply as the assets of Newco Ltd will have been used for the purposes of the trade within the 75% group for at least 12 months up to the date of transfer.

Z plc

The key advantage for Z plc is that it will acquire the trading loss as well as the trade and assets of Newco Ltd.

If there is a major change in the nature or conduct of its trade within five years (starting up to three years pre change in ownership), the trading losses will not be available to set against any future profits after the change in ownership.

Also, Z plc will acquire a 'clean' company, with no latent contingent liabilities.

12 Investment in companies

This section looks at the different levels of investment that can be made in other companies and the tax effects.

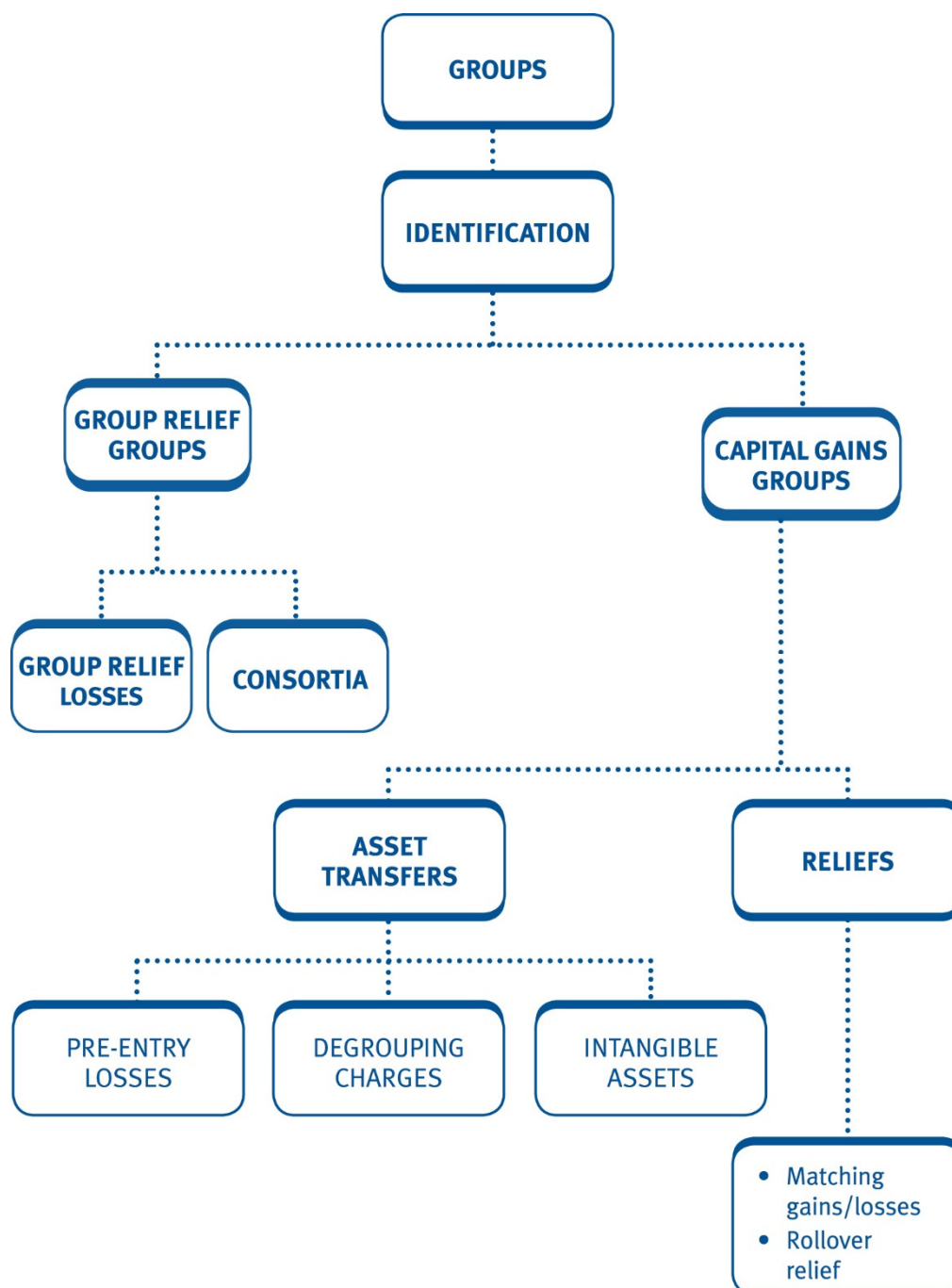
Stake purchased in UK company	< 50%	> 50% but < 75%	≥ 75%
Associated company	No	Yes	Yes
Can join VAT group (Chapter 26)	No	Yes	Yes
Group relief group	No	No	Possible (1)
Consortium relief	Possible (2)	Possible (2)	No
Gains group	No	No	Possible (3)
Other issues	Yes	Possible loss of b/f losses if: major change in nature/conduct of trade, or revival of negligible activities	
(1) Losses b/f can be used			
(2) Stamp duty	0.5% on share purchases		

Notes:

- (1) It depends on the group structure. For a new subsidiary to participate in group relief it must be a 75% subsidiary of its direct parent company, and an effective 75% indirect subsidiary of the ultimate parent company.
- (2) It depends on ownership of remaining shares. For a consortium at least 75% of the shares in the consortium company must be owned by companies, each of whom has at least a 5% stake.
- (3) It depends on the group structure. For a new subsidiary to participate in gains group reliefs it must be a 75% subsidiary of its direct parent company, and an effective 51% indirect subsidiary of the ultimate parent company.

	Joining a 75% group	Leaving a 75% group
Associated company	<ul style="list-style-type: none"> Associated for whole of AP in which purchase takes place. 	<ul style="list-style-type: none"> Associated for whole of AP in which sale takes place.
Group relief	<ul style="list-style-type: none"> Only possible from date of joining group. Cannot surrender pre-acquisition losses for five years after joining. 	<ul style="list-style-type: none"> Ceases from date 'arrangements' come into force for company to leave group.
Capital losses	<ul style="list-style-type: none"> Pre-acquisition capital losses cannot be used to relieve gains in other group companies. 	<ul style="list-style-type: none"> No relief against group gains for capital losses realised after leaving group.
Degrouping charge	<ul style="list-style-type: none"> Not applicable. 	<ul style="list-style-type: none"> Arises if company leaves gains group still owning asset which it received from another gains group member on a NGNL transfer within the last six years. Degrouping gain added to parent company share proceeds. SSE may be available.
VAT	<ul style="list-style-type: none"> No VAT on share sales or purchases. Can join a VAT group but is optional (Chapter 26). 	<ul style="list-style-type: none"> No VAT on share sales or purchases. Will leave VAT group unless parent company still owns > 50%.
Stamp duty levied	<ul style="list-style-type: none"> Purchaser pays 0.5% on share purchases. 	<ul style="list-style-type: none"> No stamp duty for vendor.
Stamp taxes 'group transfers'	<ul style="list-style-type: none"> Transfers of property between 75% group members exempt from stamp taxes. 	<ul style="list-style-type: none"> Stamp taxes may be payable if leave group owning an asset transferred in by another group member with SD/SDLT exemption within last three years.

13 Chapter summary



Test your understanding answers



Test your understanding 1

X plc**(i) Group loss relief group**

There are two group relief groups:

Group 1: X plc and its 75% directly and indirectly owned subsidiaries Y Inc, C Ltd, A Ltd and Z Ltd.

Note that B Ltd cannot be included in this group as X plc's indirect interest is only 72% ($80\% \times 90\%$).

Group 2: A Ltd and B Ltd.

(ii) Capital gains group

The gains group consists of:

X plc, A Ltd, B Ltd, Y Inc, C Ltd and Z Ltd.

B Ltd can be included in the main group with X plc as A Ltd has a holding $\geq 75\%$ in B Ltd and X plc has an indirect interest in B Ltd of $> 50\%$.

D Ltd is not a member of the gains group even though X plc has an indirect interest of 52% ($100\% \times 80\% \times 65\%$) as D Ltd is not a 75% subsidiary of C Ltd.

Note that although Y Inc (the overseas company) is included in the definition of the groups, it cannot enjoy any group advantages.



Test your understanding 2

A Ltd and B Ltd**(a) Maximum group relief – y/e 31 December 2023**

Lower of:

(1) A Ltd's TTP in corresponding period $8/12 \times £25,000 = £16,667$

(2) B Ltd's loss in corresponding period $8/11 \times £20,000 = £14,545$

Y/e 31 December 2023 – A Ltd's revised TTP calculation

	£
TTP	25,000
Less: Group relief	(14,545)
	<hr/>
Revised TTP	10,455
	<hr/>

(b) Maximum group relief – y/e 31 December 2024

Lower of:

(1) A Ltd's TTP in corresponding period $3/12 \times £17,000 = £4,250$ (2) B Ltd's loss in corresponding period $3/11 \times £20,000 = £5,455$ **Y/e 31 December 2024 – A Ltd's revised TTP calculation**

	£
TTP	17,000
Less: Group relief	(4,250)
	<hr/>
Revised TTP	12,750
	<hr/>

**Test your understanding 3****Romeo Ltd****Corporation tax computations**

	Romeo Ltd 12 months to 31.12.23	Juliet Ltd 9 months to 31.3.24
	£	£
Trading profit	890,000	0
Interest income	6,000	4,000
Property income	2,000	8,000
Chargeable gains		15,000
	<hr/>	<hr/>
Total profits	898,000	27,000
Less: Loss brought forward		(22,000)
QCD relief	(4,000)	(5,000)
	<hr/>	<hr/>
	894,000	0
Less: Group relief (W2)	(68,000)	
	<hr/>	<hr/>
TTP	826,000	0
	<hr/>	<hr/>
Corporation tax (W4)		
FY2022 ($£826,000 \times 19\% \times 3/12$)	39,235	
FY2023 ($£826,000 \times 25\% \times 9/12$)	154,875	
	<hr/>	<hr/>
	194,110	0

Note: The dividends received are exempt from corporation tax. The augmented profits for Romeo Ltd are the same as the TTP as dividends from associated companies are excluded.

Workings:

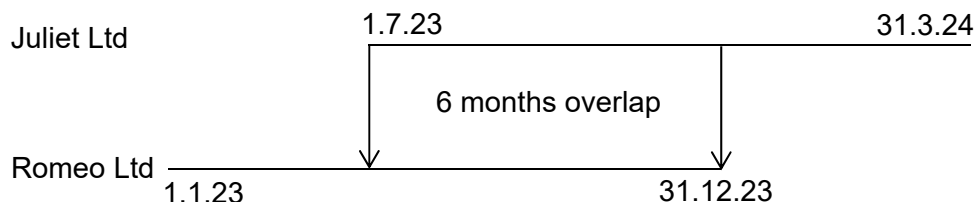
(W1) Loss available for group relief

The maximum amount of loss that Juliet Ltd can surrender using group relief is calculated as follows:

	£	£
Trading loss – current period		(77,000)
Excess trading loss b/f:		
Trading loss b/f	(52,000)	
Less: Current period total profits	27,000	
	<u> </u>	(25,000)
Maximum loss available for group relief		<u>(102,000)</u>

(W2) Maximum group relief

The corresponding accounting period, is six months to 31 December 2023 (1 July 2023 to 31 December 2023).



Therefore, maximum group relief = lower of:

- (a) Loss of Juliet Ltd (£102,000 (W1) × 6/9) = £68,000
- (b) Romeo Ltd's TTP (£894,000 × 6/12) = £447,000

(W3) Juliet Ltd loss memo

	£
Trading loss – current period	77,000
Trading loss b/f	52,000
Group relief to Romeo Ltd	(68,000)
Offset b/f loss against total profits (Note)	(22,000)
	<u> </u>
Loss to c/f	39,000

Note: As Juliet Ltd has a QCD of £5,000 it would only claim to use £22,000 of the brought forward trading loss to avoid wasting the QCD.

(W4) Romeo Ltd corporation tax rate

Romeo Ltd's 12-month AP to 31 December 2023 falls partly into FY2022 and partly into FY2023.

There are two associated companies, so the limits for FY2023 are:

$$£250,000/2 = £125,000$$

$$£50,000/2 = £25,000$$

Augmented profits are above the upper limit so the main rate applies.

**Test your understanding 4****A Ltd and B Ltd**

- (i) This is not a consortium.
A Ltd has $\geq 75\%$ of C Ltd so this is a 75% group.
- (ii) This is a consortium.
D Ltd, C Ltd and F Ltd own $\geq 75\%$ of G Ltd and each own $\geq 5\%$.
G Ltd is the consortium company and D Ltd, C Ltd and F Ltd are consortium members.

**Test your understanding 5****P Ltd and Q Ltd**

	P Ltd £	Q Ltd £
Maximum CR = lower of		
(1) Available TTP of members	50,000	15,000
(2) Available loss of consortium company		
$70\% \times £60,000$	42,000	
$30\% \times £60,000$		18,000
Maximum amount	42,000	15,000

X Ltd and Y Ltd

X Ltd can use part of its loss to relieve up to 40% of C Ltd's TTP = £20,000.

X Ltd cannot surrender any of its loss to Y Ltd.



Test your understanding 6

Blue Ltd, Rose Ltd, Pink Ltd and Mauve Ltd

(i) Corporation tax computations

Blue Ltd	£
TTP	300,000
Consortium relief (W):	
– From Rose Ltd	(45,000)
– From Pink Ltd	(105,000)
	<hr/>
TTP	150,000
	<hr/>
CT Liability ($£150,000 \times 25\%$)	37,500
Less: Marginal relief	(1,500)
$(£250,000 - £150,000) \times 3/200$	
	<hr/>
	36,000
	<hr/>
Rose Ltd	£
CT liability	0
	<hr/>
Loss carried forward (W)	45,000
	<hr/>
Pink Ltd	
CT liability	0
	<hr/>
Loss carried forward (W)	21,000
	<hr/>
Mauve Ltd	£
TTP	55,000
	<hr/>
CT liability ($£55,000 \times 25\%$)	13,750
Less: Marginal relief ($£250,000 - £55,000) \times 3/200$	(2,925)
	<hr/>
	10,825
	<hr/>

Note: Mauve Ltd has exactly 50% of the share capital of Blue Ltd (not more than 50%), and so none of the companies are associated companies and the full limits are compared to the augmented profits.

Working: Maximum consortium relief

	Rose Ltd	Pink Ltd
	£	£
Lower of:		
Consortium member loss	90,000	126,000
% of consortium company TTP		
15% × £300,000	45,000	
35% × £300,000		105,000
Loss memo:	£	£
Trading loss	90,000	126,000
Consortium relief to Blue Ltd	(45,000)	(105,000)
	<hr/>	<hr/>
Loss left to c/f	45,000	21,000
	<hr/>	<hr/>

(ii) **If Rose Ltd owned 80% of Blue Ltd**

The two companies would be associated and would form a group relief group.

The whole of Rose Ltd's loss would be available as group relief to reduce the TTP of Blue Ltd to £210,000 (£300,000 – £90,000).

With one associated company the limits would be divided by two:

$$£250,000/2 = £125,000$$

$$£50,000/2 = £25,000$$

Accordingly, Blue Ltd would pay tax at the main rate.

Pink's loss would no longer be available to Blue Ltd and would have to be used by Pink Ltd only.

Mauve Ltd would be unaffected.



Test your understanding 7

Green Ltd

Intergroup transfer:	£
Cost	100,000
Plus: IA (April 1997 to October 2007)	
$0.337 \times £100,000$	33,700
	<hr/>
Base cost	133,700
	<hr/>
Sale outside the group:	£
Proceeds	350,000
Less: Base cost	(133,700)
	<hr/>
Unindexed gain	216,300
Less: IA (Oct 2007 to Dec 2017) (IA frozen at Dec 2017)	
$0.331 \times £133,700$	(44,255)
	<hr/>
Chargeable gain	172,045
	<hr/>



Test your understanding 8

Orange Ltd

When Orange Ltd leaves the group, the company still owns an asset which it had acquired from Yellow Ltd in the six years preceding Orange Ltd's departure.

Orange Ltd is treated as if it had sold the building on 1 December 2018 at its market value on that date, and then immediately reacquired it.

	£
Proceeds	375,000
Less: Base Cost: (Note):	
Cost to Yellow Ltd	(180,000)
IA (Aug 2000 – Dec 2017)	
$0.631 \times £180,000$	(113,580)
	<hr/>
Degrouping charge	81,420
	<hr/>

The degrouping charge is added to the consideration received by Yellow Ltd on sale of the shares in Orange Ltd. However, any gain is likely to be exempt under the substantial shareholding exemption rules as Yellow Ltd has owned 10% of the shares for 12 months out of the previous six years.

Note: Orange Ltd's cost is the original cost to Yellow Ltd plus the indexation allowance from the date of purchase by Yellow Ltd to December 2017, as this is earlier than the date of transfer to Orange Ltd.



Test your understanding 9

Mauve Ltd and Violet Ltd

Year ended 31 March 2024 – taxable total profits computation

The limits would be divided by two associated companies:

$$£250,000/2 = £125,000$$

$$£50,000/2 = £25,000$$

Before taking account of the gain, Violet Ltd is therefore paying tax at the main rate of 25% with profits of £250,000 and Mauve Ltd is paying tax at the small profits rate of 19% with profits of £10,000.

To minimise tax for the group as a whole:

- Violet Ltd and Mauve Ltd should dispose of their chargeable assets realising their chargeable gain and allowable capital loss.
- The group should then make an election by 31 March 2026 to reallocate the capital loss in Violet Ltd to Mauve Ltd.
- As a result, the chargeable gain and capital loss are treated as being realised by Mauve Ltd.
- This leaves a net gain of £25,000 (£100,000 – £75,000), which would then bring Mauve Ltd's profits into the marginal band so that tax at 26.5% would be suffered on the part of the gain falling between the limits. To avoid this, £10,000 of the gain should be reallocated to Violet Ltd where it will be taxed at the main rate of 25%, leaving £15,000 of gain in Mauve Ltd.
- Alternatively, the same result could be achieved by transferring £85,000 of Mauve Ltd's gain to Violet Ltd, leaving a net gain of £10,000 (£85,000 – £75,000) in Violet Ltd and a gain of £15,000 (£100,000 – £85,000) in Mauve Ltd.

Revised corporation tax computations would be as follows:

	Mauve Ltd	Violet Ltd
	£	£
Trading profits	10,000	250,000
Net chargeable gain	15,000	10,000
	<hr/>	<hr/>
TTP	25,000	260,000
	<hr/>	<hr/>
Tax rate	19%	25%

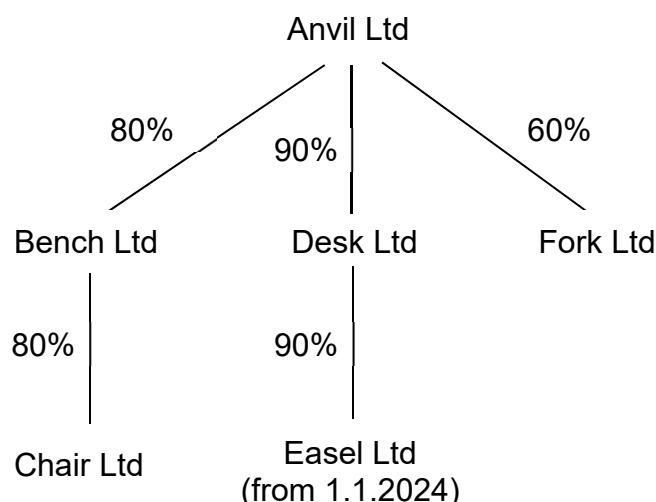


Test your understanding 10

Anvil Ltd

(a) (i) Group relationships

The group structure of the Anvil group is as follows:



Group relief

For group relief purposes, two companies are members of a 75% group where one of them is a 75% subsidiary of the other, or both of them are 75% subsidiaries of the parent company.

To qualify as a 75% subsidiary, the parent company must hold 75% or more of the subsidiary's ordinary share capital, and have the right to receive 75% or more of its distributable profits and net assets (were it to be wound up). The 75% holding must be an effective interest that is held directly or indirectly.

Capital gains

For the purposes of transferring chargeable assets between two companies without incurring a chargeable gain or an allowable loss, the definition of a 75% subsidiary is 'less rigorous' than for group relief. The 75% holding must only be met at each level in the group structure, subject to the principal company having an effective interest of over 50%.

Associated companies

All companies are associated. Easel Ltd is associated for the full accounting period, even though it was acquired part way through the period.

The limits for corporation tax will be divided by six:

$$£250,000/6 = £41,667$$

$$£50,000/6 = £8,333$$

Losses groups

The 75% losses groups are as follows:

- Anvil Ltd, Bench Ltd, Desk Ltd, Easel Ltd (from 1 January 2024); **not** Chair Ltd as the effective holding is only 64% ($80\% \times 80\%$); **not** Fork Ltd as the direct share is only 60%.
- Bench Ltd and Chair Ltd form a separate losses group.

Gains group

The 75% gains group is as follows:

- Anvil Ltd, Bench Ltd, Chair Ltd, Desk Ltd, Easel Ltd (from 1 January 2024); **not** Fork Ltd as the direct share is only 60%.

(ii) Surrender of trading losses

The most important factor that should be considered when deciding which group companies the trading losses should be surrendered to is the rate of corporation tax applicable to those companies.

Surrender should be made initially to companies subject to corporation tax at the marginal rate of 26.5%. The amount surrendered should be sufficient to bring the claimant company's profits down to the lower limit.

Surrender should then be to those companies subject to the main rate of corporation tax of 25%, and lastly to companies subject to corporation tax at the small profits rate of 19%.

The ability of companies with minority interests to compensate for group relief surrenders will be another factor.

(b) (i) Corporation tax computations – y/e 31 March 2024						
	Anvil Ltd	Bench Ltd	Chair Ltd	Desk Ltd	Easel Ltd	Fork Ltd
	£	£	£	£	£	£
Trading profit	500,000	0	0	0	0	0
Interest income	0	35,000	0	30,000	160,000	0
Net gains (Note 1)	0	0	7,000	0	0	0
Total profits before loss relief	500,000	35,000	7,000	30,000	160,000	0
Tax rate	25%	26.5%	19%	26.5%	25%	
Brought forward loss					(20,000)	
Current year loss (Note 2)				(21,667)		
Group relief (Note 2)	(81,666)	(26,667)	0	0	0	0
TTP	418,334	8,333	7,000	8,333	140,000	0
(ii) Explanation of reliefs						
(1) Capital gains						
An election should be made to reallocate Anvil Ltd's capital loss to Chair Ltd, so that it can be set against Chair Ltd's chargeable gain.						
Alternatively, an election could be made to reallocate £10,000 of Chair Ltd's chargeable gain to Anvil Ltd, which would achieve the same result.						
The whole chargeable gain should not be reallocated to Anvil Ltd, as Anvil Ltd is taxed at 25%, whereas Chair Ltd is only taxed at 19%.						
(2) Relief for trading losses						
Fork Ltd's loss						
Fork Ltd is not part of a losses group, so its loss cannot be surrendered.						
This loss could be carried back for 12 months against total profits of Fork Ltd, or otherwise will be carried forward against Fork Ltd's future total profits.						

Easel Ltd's loss

Easel Ltd's loss brought forward can be used against total profits in Easel Ltd. As Easel Ltd has sufficient profits it should use the loss now rather than carry it forward to future years.

There is no possibility of group relieving this loss, as brought forward losses can only be surrendered to the extent that they cannot be used against the surrendering company's own total profits. In any case, as Easel Ltd's loss is a pre-acquisition loss, it could not be surrendered against group profits for a period of five years after Easel Ltd joined the group.

Desk Ltd's loss

The aim in setting off Desk Ltd's loss of £130,000 is to save tax at the highest possible rate.

Using the loss against its own profits and surrendering to Bench Ltd will save tax at an effective rate of 26.5% in the marginal band.

The remaining loss should then be surrendered to either Anvil Ltd or Easel Ltd to save tax at 25%.

The surrender to Easel Ltd is restricted, as Easel Ltd has only been part of the group since 1 January 2024:

Maximum surrender by Desk Ltd

$$(3/12 \times £130,000) = £32,500$$

Maximum claim by Easel Ltd against TTP for the corresponding period: $(3/12 \times £140,000) = £35,000$

The maximum surrender to Easel Ltd is therefore £32,500, whereas the full balance of the loss could be surrendered to Anvil Ltd.

The loss should be used as follows:

	£
Total loss	130,000
Surrender to Bench Ltd; reduce profits to lower limit to save 26.5% tax	(26,667)
Surrender to Anvil Ltd (see above) to save 25% tax	(81,666)
Claim in Desk Ltd to save 26.5% tax (Note)	(21,667)
	<hr/>
	0
	<hr/>

Note: The claim to set the trading loss against Desk Ltd's own profits is an all or nothing claim, and cannot be restricted. In order to leave £8,333 profit in Desk Ltd, the group relief surrenders should be made first, leaving just £21,667 loss to set off in Desk Ltd.

Overseas aspects of corporation tax

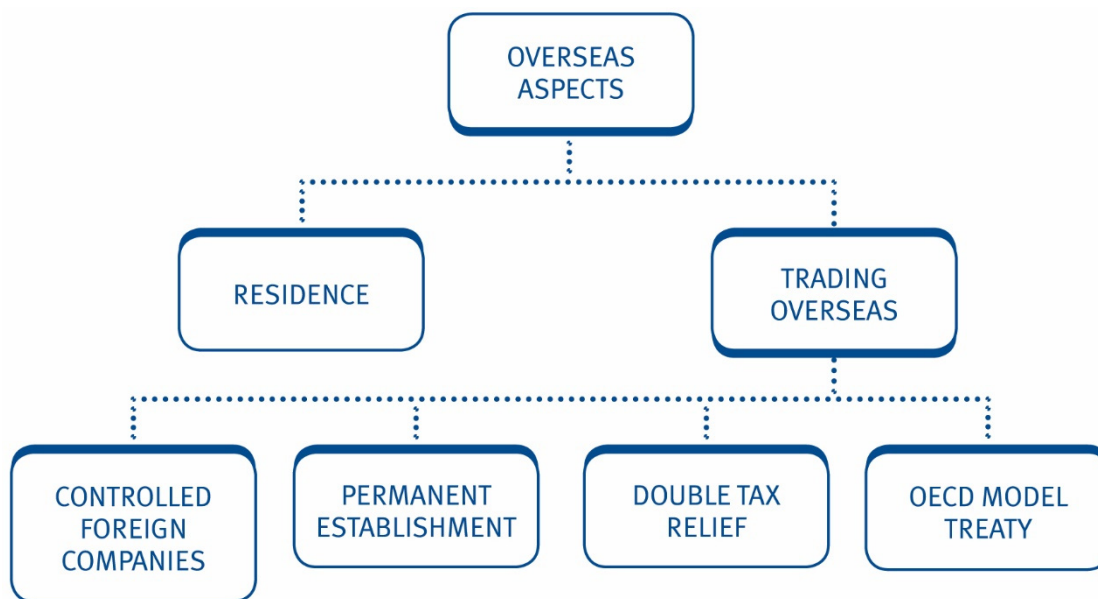
Chapter learning objectives

Upon completion of this chapter you will be able to:

- assess the impact of the OECD model double tax treaty on corporation tax
- evaluate the meaning and implications of a permanent establishment
- identify and advise on the tax implications of controlled foreign companies
- advise on the tax position of overseas companies trading in the UK
- calculate double taxation relief
- advise on the tax treatment of an overseas branch.



One of the PER performance objectives (PO17) is to assess the tax implications of proposed activities or plans, referring to up-to-date legislation. Working through this chapter should help you understand how to demonstrate that objective.



Introduction



This chapter considers the overseas aspects of corporation tax. Much of the content of this chapter is new, apart from the definition of residence for a company which you will have seen previously in TX.

This chapter aims to show the impact of:

- UK resident companies trading overseas via a branch or an overseas company set up for the purpose, and
- overseas companies trading in the UK.

1 Company residence

Determining UK residence

Under UK law, a company is resident in the UK if it is:

- **incorporated** in the UK, or
- incorporated elsewhere, but has its place of **central management and control in the UK**.

The centre of management and control is where the key operational and financial decisions are made. HMRC will look at factors such as:

- the location of the board meetings
- where the effective day-to-day management decisions are made, and
- the residence status of the directors.

No one factor is conclusive in determining the centre of management and control.

Note that other countries may have different definitions to determine residency status. Therefore, it is possible for a company to have dual residence status.

For example, a company incorporated in another country may be treated as resident there, but if it were centrally managed and controlled in the UK it would also be treated as resident in the UK.

Implications of UK residence

A UK resident company is chargeable to corporation tax on its worldwide profits. This includes:

- all UK profits
- overseas branch profits (unless exemption election made – section 3)
- other overseas income (e.g. rental income and interest income), and
- chargeable gains.



2 OECD model tax treaty

The OECD (Organisation for Economic Cooperation and Development) is an organisation of developed countries whose main purpose is to maintain financial stability and the expansion of world trade.

In order to help avoid double taxation between countries, the OECD has published a model Double Taxation Convention with an accompanying commentary.

Significance of the OECD model tax treaty

The UK has a large number of tax treaties with other countries. Whenever a new treaty is drawn up or an old treaty is renegotiated, the OECD model is used as a guide.

Detailed knowledge of treaties is not required in your examination but you are required to understand the impact of the OECD model tax treaty on corporation tax.

The main function of any treaty is to avoid double taxation and to decide which country shall have the right to tax income (the 'primary taxing rights').



Contents of the model treaty

Some of the main areas covered in the treaty are as follows:

- Article 1: states that companies which are covered by the treaty are those resident in one or both of the countries involved.
- Article 4: explains that residence is determined by the laws of a state (i.e. not by the model treaty itself). It includes a 'tie breaker' clause to be applied when a company appears to be resident in two countries.
- In this case, residence is where the place of 'effective management' is situated. This is usually where the head office, main company records and senior staff are located.
- Article 5: deals with the meaning of 'permanent establishment' (section 3).
- Articles 6 to 22: deal with the treatment of different types of income.
- Article 23: explains the two methods of giving relief for double taxation
- exempting the income in one state and taxing it only in the other, or
 - the credit method which gives credit in one state for the tax levied by the other. The credit method (also known as unilateral relief) is covered in section 4.



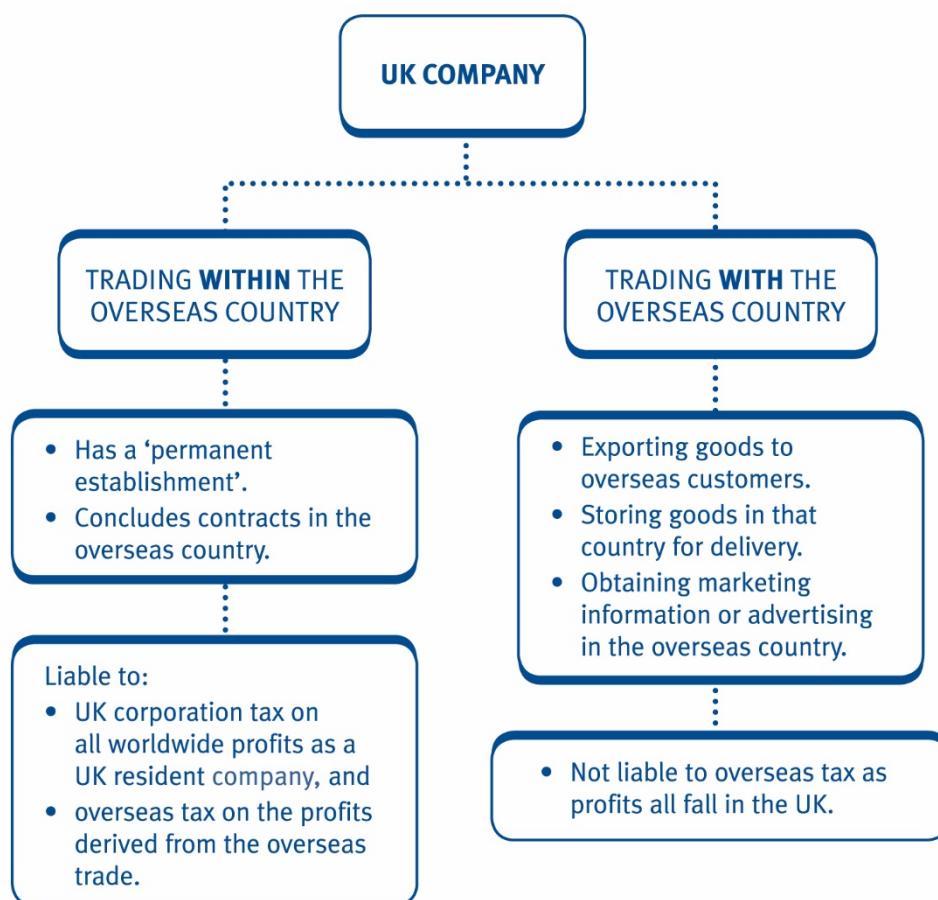
3 Trading overseas

The taxation of overseas trading income

The normal provision in tax treaties (based on the OECD model tax treaty) is that an overseas country will usually only tax income arising in its country from the commercial operation of a UK resident company if:

- a trade is carried on **within its boundaries**, and
- the profits are derived from a **permanent establishment** set up for that purpose.

The term 'within a country's boundaries' is important, as trading with, as opposed to **within**, another country will avoid any liability to overseas revenue taxes.



Permanent establishment



The term 'permanent establishment' within an overseas country includes:

- a place of management
- a branch
- an office
- a factory, a workshop or any mine or other place of extraction of natural resources.

A UK resident company that has a permanent establishment trading within an overseas country will normally:

- be charged to tax on its overseas profits arising
- by both HMRC under the UK residence rule, and
- the overseas tax authority under their own tax code.

Double taxation relief (DTR) will be available (section 4).

Election to exempt profits of overseas permanent establishment

It is possible for a UK company to make an irrevocable election to exempt profits of its overseas permanent establishments (PE) from UK corporation tax such that there is:

- no UK tax on the profits of the overseas PE, but
- no relief available for losses of the overseas PE in the UK
- no UK capital allowances available for assets used by the overseas PE, and
- no UK tax on capital gains arising in the overseas PE.

Note however that an overseas PE does not affect the corporation tax threshold for payment by instalments or determining the relevant corporation tax rate, whether or not the election is made.

The exemption election:

- can be made at any time
- is effective from the start of the accounting period following that in which the election is made, and
- once made, applies to all overseas PEs of that company.

Tax planning

It may not be beneficial to make the election if:

- (i) double tax relief means that there is little or no UK corporation tax payable, and/or
- (ii) losses are possible or anticipated in any overseas branch in the future, as the election applies to all branches of the company, current and future.

Alternative overseas investment structures

Companies have the option of structuring their business operations and investments in various ways.

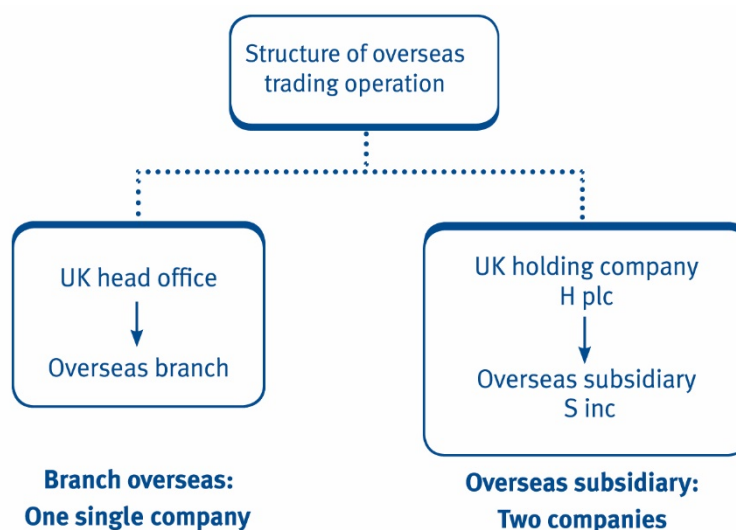
The two principal methods of setting up a permanent place of business overseas are:

- (i) setting up a branch (or division), or
- (ii) incorporating a new subsidiary (i.e. setting up an overseas resident company).

Note that:

- The branch or division will probably be regarded as a permanent establishment and hence may be subject to both UK and local taxes.
- The new subsidiary will be incorporated overseas. Provided that it is centrally managed and controlled in the overseas country, it will be resident there for tax purposes and not in the UK.

- There are fundamental differences for tax purposes between the two structures.



Overseas dividends

Overseas dividends are treated in the same way as UK dividends:

- They are exempt from corporation tax.
- They are included in augmented profits, unless the dividends are received from associated companies, in which case they are ignored completely for corporation tax purposes.

The tax implications of both structures

	Overseas branch	Overseas subsidiary
Scope and basis of charge	<ul style="list-style-type: none"> Extension of UK operations. All profits arising taxed on UK company. If the branch is controlled from the UK: <ul style="list-style-type: none"> then its trading profit is added to UK trading profit. If trade is the same as in UK: <ul style="list-style-type: none"> included in trading income, and available for relief of b/f trading losses. DTR available. Can elect for profits to be exempt. 	<ul style="list-style-type: none"> Overseas profits not assessed in UK if left in overseas subsidiary. Profits remitted to UK parent company may be chargeable when received: <ul style="list-style-type: none"> dividends <i>not</i> taxable interest income from loan to overseas subsidiary is taxable.

Trading loss relief	<ul style="list-style-type: none"> • Can relieve trading losses of overseas PE against UK profits: <ul style="list-style-type: none"> – unless the loss can be relieved in the country in which it arose. • UK losses can be relieved against overseas PE profits. • No relief if election for branch exemption made. 	<ul style="list-style-type: none"> • UK trading loss <ul style="list-style-type: none"> – cannot be surrendered to overseas resident subsidiary. • Loss from 75% subsidiary resident overseas <ul style="list-style-type: none"> – cannot be surrendered to UK parent.
Capital allowances	<ul style="list-style-type: none"> • Available on overseas located assets purchased and used by overseas branch, unless election for branch exemption made. 	<ul style="list-style-type: none"> • Not available under UK tax rules.
Chargeable gains	<ul style="list-style-type: none"> • Capital gains computed using UK rules. • Rollover relief is available on reinvestment. • Capital losses can be utilised. • No capital gains or utilisation of capital losses if branch exemption election made. 	<ul style="list-style-type: none"> • Not assessed in UK.
Impact on tax rate and payments	<ul style="list-style-type: none"> • None (as not a separate entity). 	<ul style="list-style-type: none"> • As an associated company, the upper and lower limits for marginal relief and the threshold for payment by instalments are reduced.

Tax planning

Where a new overseas operation is expected to make losses initially, it may be advantageous to set it up as a branch.

Once the overseas operation expects to be profitable, its trade can be transferred to an overseas resident subsidiary company so that its profits are not taxable in the UK (if paid as dividends).

- Starting as a branch would enable the UK company to offset the losses against its other profits.

- The transfer of the trade represents a disposal of the assets of the branch at MV which may lead to:
 - balancing adjustments in respect of assets qualifying for capital allowances, and
 - chargeable gains.
- Where all of the assets of the branch (excluding cash) are transferred to the overseas company in exchange for shares:
 - an election is available
 - to defer any gains arising until the overseas company is sold.
- The deferred gains will also be charged if the overseas company disposes of the assets transferred to it within six years of acquisition.
- Consideration should be given as to whether or not it is necessary to obtain the consent of the Treasury for the transfer of the trade to the overseas company. This is because it is generally illegal for a UK resident company to permit a non-UK resident company over which it has control to create or issue shares.

Alternatively, an election could be made to exempt the profits and gains of the branch once profitable. However, as this election applies to all overseas permanent establishments and is irrevocable, this would require careful consideration.



Illustration 1 – Branch vs. subsidiary

Explain the advantages for taxation purposes of operating overseas through a branch rather than through an overseas subsidiary, assuming that a branch exemption election has not been made.

Solution

Advantages of operating through an overseas branch

- (1) Relief is usually available in the UK for trading losses if incurred by an overseas branch, but no UK relief is available for trading losses incurred by an overseas subsidiary.
- (2) UK capital allowances (including SBAs) are available in respect of qualifying assets purchased by an overseas branch.
- (3) Unlike an overseas subsidiary, an overseas branch cannot be an associated company. The UK corporation tax limits and threshold for payment by instalments will therefore not be reduced.

Overseas companies trading in the UK



A non-UK resident company can be liable to UK corporation tax on trading profits if it trades **within** the UK, but not for trading **with** the UK.

- Trading within the UK means either trading through a permanent establishment or concluding contracts in the UK.
- Trading with the UK means activities such as exporting goods to UK customers, storing goods in the UK for customers and advertising and marketing activities in the UK.

Corporation tax is generally charged at the main UK rate (i.e. no small profits rate or marginal relief) unless there is a double taxation treaty specifying a lower rate.



Illustration 2 – Trading in the UK

Morn Inc is a large company resident in the country of Shortland. Morn Inc manufactures mobile telephones in Shortland, and has been selling these in the UK since 1 September 2023.

Initially, Morn Inc sold the telephones through a UK based agent and stored the telephones in a rented warehouse. On 1 February 2024 Morn Inc rented an office and showroom in London which were staffed initially by two sales managers and an administrator from Shortland.

Morn Inc intends to incorporate a UK subsidiary company on 31 December 2024 to operate the UK business.

There is no double tax treaty between the UK and Shortland.

Advise Morn Inc of its liability to UK corporation tax during the period from 1 September 2023 to 31 December 2024.

Solution

Morn Inc will be liable to UK corporation tax (CT) if it is trading through a permanent establishment in the UK (i.e. trading within the UK). The company will not be liable to UK CT if it is merely trading with the UK.

From 1 September 2023 to 31 January 2024, Morn Inc employed a UK agent, and maintained an inventory of telephones in the UK. Provided that contracts for the sale of the telephones are concluded in Shortland, Morn Inc will probably not be liable to UK CT on profits made during this period.

On 1 February 2024, Morn Inc would appear to have opened a permanent establishment in the UK by renting an office and showroom, and it is likely that the sales managers will be empowered to conclude contracts in the UK.

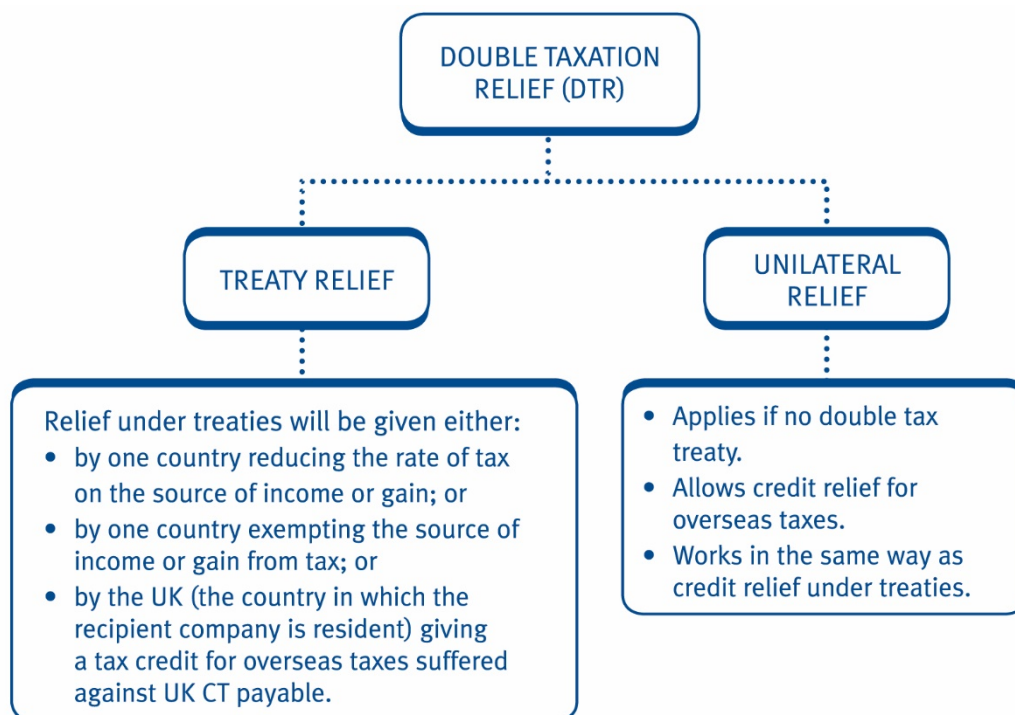
Morn Inc will therefore be liable to UK CT on the profits made in the UK during the period from 1 February 2024 to the date that the trade is transferred to the new company (presumably 31 December 2024).

CT will be charged at the main UK rate regardless of the level of profits made in the UK, or by Morn Inc, since there is no double taxation treaty between the UK and Shortland.



4 Double taxation relief

UK resident companies can get relief for overseas taxes suffered in the following ways:



Calculation of unilateral (credit) relief

All overseas income must be included in the corporation tax computation gross (i.e. including any overseas taxation suffered).

Relief is available for overseas withholding tax (WHT) as follows:

- WHT = any overseas tax deducted at source from overseas income.
- If the **amount** of WHT is given
 - simply add it back to the net income to give the gross amount.
- If the **rate** of WHT is given
 - gross up as normal.

DTR is the **lower** of:

- (i) overseas tax suffered, and
- (ii) UK CT attributable to the overseas income (using effective rate).



Illustration 3 – DTR

UK Ltd is a UK resident company. The company's UK trading profit for the y/e 31 March 2024 is £37,000. UK Ltd has an overseas branch and an overseas subsidiary, and has not elected for overseas branch profits to be exempt.

Overseas branch

The branch is controlled from overseas. It has a trading profit of £68,000 for the y/e 31 March 2024. The overseas corporation tax on these profits is £26,000.

Overseas subsidiary

UK Ltd owns 80% of the share capital of Overseas Inc, a company that is resident overseas. UK Ltd received a dividend of £80,750 during the y/e 31 March 2024. This dividend was net of withholding tax of £4,250.

Calculate UK Ltd's CT liability for the y/e 31 March 2024.

Solution

	Total £	UK £	Branch £
Trading profits = TTP	105,000	37,000	68,000
CT @ 25%	26,250	9,250	17,000
Less: MR (W1) (£125,000 – £105,000) × 3/200	(300)		
CT before DTR (W2)	25,950	9,144	16,806
Less: DTR (W3)	(16,806)		(16,806)
CT liability	9,144	9,144	0

Workings

(W1) Corporation tax rate

Overseas Inc is an associated company, so the limits for corporation tax purposes are:

£125,000 (£250,000/2)

£25,000 (£50,000/2)

The dividend received from Overseas Inc is intra-group income, and is therefore not included in augmented profits.

TTP = Augmented profits and marginal relief applies.

(W2) Allocation of corporation tax

Average rate of tax = $(£25,950/£105,000) \times 100 = 24.7143\%$

CT on UK income: $(£37,000 \times 24.7143\%) = £9,144$

CT on overseas branch: $(£68,000 \times 24.7143\%) = £16,806$

(W3) DTR

Lower of:	£
(i) Overseas tax	26,000
(ii) UK CT (W2)	16,806

Note: There is no DTR for the withholding tax suffered on the dividend received, as the dividend is not taxable in the UK.

**Test your understanding 1**

River plc has received rent of £119,000 in the year ended 31 March 2024 from an overseas property.

A WHT rate of 15% has been applied to the rent received by River plc.

Compute the CT payable by River plc, on the assumption that River plc has UK trading profits of £900,000 in the year ended 31 March 2024 in addition to the overseas income but no other income or gains.

Further aspects of DTR

If there is more than one source of overseas income, basic DTR is computed on each overseas source separately.

- A columnar approach is recommended in computations.
- In computing the UK CT attributable to an overseas source, general loss reliefs (current year, carry back, carry forward, group relief) and QCD relief can be set off in the most beneficial manner as follows:
 - first against UK sources
 - then against the source suffering the **lowest rate** of overseas tax.



Illustration 4 – DTR with losses

London Ltd, a UK resident trading company, owns two overseas branches, one in Paris and one in Rome.

It also owns 4% of the share capital of Berlin GmbH, an overseas company and owns an overseas property from which it receives rental income.

The following information relates to London Ltd's y/e 31 March 2024:

	£
Tax adjusted trading profits	38,000
Overseas income:	
Paris branch profits	
– after deduction of withholding tax of 40%	54,000
Rome branch loss	(50,200)
Rental income	
– after deduction of withholding tax of 13%	218,457
Dividend from Berlin GmbH	
– after deduction of withholding tax of 27%	2,700

Compute London Ltd's UK corporation tax payable for the y/e 31 March 2024 assuming the overseas branch exemption election:

- (a) has not been made
(b) has been made.

Solution

- (a) **Overseas branch exemption election has not been made**
Corporation tax computation – y/e 31 March 2024

	Total £	UK profits £	Paris income £	Rental income £
Trading profit	38,000	38,000		
Overseas income (W1)	341,100		90,000	251,100
Overseas branch loss (Note)	(50,200)	(38,000)		(12,200)
Total profits = TTP	328,900	0	90,000	238,900
Corporation tax (W2)				
£328,900 @ 25%	82,225	0	22,500	59,725
Less: DTR (W3)	(55,143)	0	(22,500)	(32,643)
Corporation tax payable	27,082	0	0	27,082

Notes:

- (1) The overseas branch loss is offset against the UK income first, then against the overseas income with the lowest overseas tax rate, in order to maximise the DTR.
- (2) The overseas dividend from Berlin GmbH is exempt but is included in augmented profits.

(b) **Overseas branch exemption election has been made**
Corporation tax computation – y/e 31 March 2024

	Total	UK income	Rental income
	£	£	£
Trading profit	38,000	38,000	
Overseas income (W1)	251,100		251,100
	<hr/>	<hr/>	<hr/>
Total profits = TTP	289,100	38,000	251,100
	<hr/>	<hr/>	<hr/>
Corporation tax			
£289,100 @ 25% (W4)	72,275	9,500	62,775
Less: DTR (W5)	(32,643)	0	(32,643)
	<hr/>	<hr/>	<hr/>
Corporation tax payable	39,632	9,500	30,132
	<hr/>	<hr/>	<hr/>

Less corporation tax is payable if the election is not made, because:

- relief for the overseas branch loss is not available with the election
- there is no UK tax due on the Paris branch profits anyway as this is fully covered by the DTR, and
- the corporation tax liability is correspondingly £12,550 higher (£39,632 – £27,082).

Alternative calculation of the difference
= (£50,200 branch loss × 25%) = £12,550

Note: It is not possible to make the exemption election for the current accounting period, only future periods. Therefore, London Ltd would have had to make the election before the current period began, when the results would not be known.

Workings**(W1) Grossing up the overseas income**

	Paris profits	Rental income
	£	£
Income received	54,000	218,457
Add: WHT $(40/60)/(13/87)$	36,000	32,643
	<hr/>	<hr/>
Gross income	90,000	251,100
	<hr/>	<hr/>

(W2) Corporation tax rate – no branch exemption election

	£
TTP	328,900
Add: Dividend received	2,700
	<hr/>
Augmented profits	331,600
	<hr/>

With augmented profits greater than £250,000 the main rate applies.

(W3) DTR – without election

	Paris profits	Rental income
	£	£
Lower of:		
UK CT on overseas profits	22,500	59,725
Overseas taxed suffered (W1)	36,000	32,643
Lower amount	22,500	32,643
	<hr/>	<hr/>

(W4) Corporation tax rate – branch exemption election

	£
TTP	289,100
Add: Dividend received	2,700
	<hr/>
Augmented profits	291,800
	<hr/>

With augmented profits greater than £250,000 the main rate applies.

(W5) DTR – with election

	Rental income
	£
Lower of:	
UK CT on overseas profits	62,775
Overseas tax suffered (W1)	32,643
Lower amount	32,643
	<hr/>

**Test your understanding 2**

Gold plc has the following income for the year ended 31 March 2024:

Trading profit	£300,000
Overseas dividends received 1 March 2024 (net of 29% WHT)	£56,800
Overseas rents received (net of 17% WHT)	£4,980

Gold plc paid a qualifying charitable donation of £100,000 in the year ended 31 March 2024.

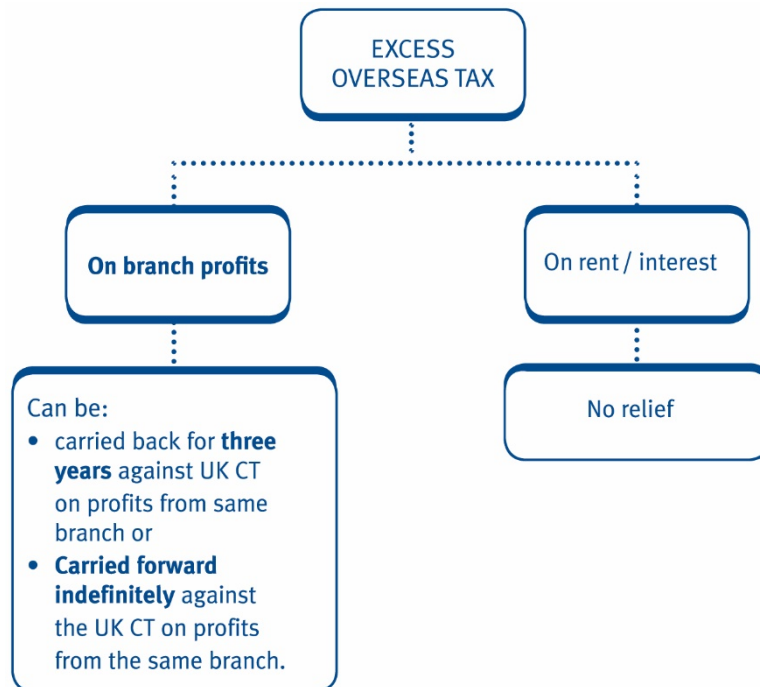
The overseas dividends are received from an overseas company in which Gold plc has a 5% interest.

Compute Gold plc's UK corporation tax payable for the year ended 31 March 2024.

Unrelieved overseas tax

Initially DTR is dealt with on a source by source basis. This can lead to overseas tax being only partly relieved.

Utilise the excess overseas taxes according to the following:



Introduction

- If a company is considering setting up an overseas subsidiary, it will be attracted to countries with low rates of tax (known as tax havens) so that it can divert profits from the UK to countries charging a lower rate of tax.
- However, there is anti-avoidance legislation in place to prevent the use of overseas companies (known as Controlled Foreign Companies (CFCs)) for this purpose.



For the ATX examination, a CFC is defined as:

- a **non-UK resident company**
- that is **controlled by UK resident** companies and/or individuals, and
- that has **artificially diverted profits** from the UK.

If certain rules are met then a corporate shareholder may suffer corporation tax in respect of its holding in the CFC, known as a CFC charge. This is covered in more detail below.



Exemptions to CFC charge

Even if shares are held in a CFC, it is rare for a CFC charge to arise due to the availability of exemptions to the charge.

The CFC charge is not applied if any **one** of the following exemptions applies:

(1) **Exempt period**

The first 12 months of the overseas company coming under the control of UK residents will be exempt from a CFC charge provided:

- it continues to be a CFC in the following accounting period, and
- it is not subject to a CFC charge in that accounting period (i.e. one of the other exemptions available now applies).

This exemption is intended to provide a period of time for companies to restructure to avoid the charge applying. It does not apply to newly incorporated companies.

(2) **Excluded territories**

HMRC provides a list of territories where rates of tax are sufficiently high to avoid a CFC charge arising.

If the CFC is resident in an excluded territory, no CFC charge arises.

(3) **Low profits**

The CFC's TTP are:

- £500,000 or less
- of which no more than £50,000 comprises non-trading profits.

(4) **Low profit margin**

The CFC's accounting profits are no more than 10% of relevant operating expenditure.

(5) **Tax exemption**

The tax paid in the overseas country is at least 75% of the UK corporation tax which would be due if the CFC were a UK resident company.

It can be difficult to remember these exemptions; you may find the following mnemonic helpful:

Energetic (**E**xempt period)

Elephants (**E**xcluded territories)

Love (**L**ow profits)

Lifting (**L**ow profit margin)

Trees (**T**ax)



Illustration 5 – Controlled foreign companies

Zoltan plc is a large UK company with annual profits of £10 million. It is considering investing overseas and has identified two possible alternative investments in Farland where the corporate tax rate is 10%.

Zoltan plc plans to buy a 70% stake in Dorn Inc, an investment company resident in Farland. Dorn Inc makes regular annual profits of £2 million. Alternatively, Zoltan plc could invest in Burton Inc which is a trading company but only produces profits of £400,000.

It is anticipated that Burton Inc could make losses in the future due to significant investment required to develop new products.

There is no double tax treaty between the UK and Farland.

Advise the tax considerations that Zoltan plc should consider before making its investment.

Solution

Dividends

- Any dividends paid by the overseas companies to Zoltan plc will be exempt for Zoltan plc.
- As Zoltan plc plans to acquire more than 50%, the dividends will not be included in augmented profits.

Controlled foreign companies

- Both of the potential investments will be classed as CFCs. They are:
 - (i) resident outside the UK
 - (ii) controlled by persons resident in the UK.
- This means that Zoltan plc could have an additional tax charge in respect of its holdings in the CFCs.
- The investment in Dorn Inc does not appear to satisfy any of the exemptions, so there may be a CFC charge in respect of the shareholding (if there are 'chargeable profits' in the CFC – see below).
- The exemption for the first 12 months of the company coming under the control of UK residents may apply, but only if there is no CFC charge in the following period.
- Burton Inc has total profits of less than £500,000, all of which are apparently from trading, so will be covered by the low profits exemption.

Loss relief

It is not possible for losses to be surrendered from an overseas resident company to a UK company.



Test your understanding 3

Wordsworth Ltd, a UK resident company, has three wholly owned overseas subsidiaries.

Explain which of the companies are likely to be exempt from the CFC rules:

- (1) Alcock Inc – resident in Ruritania where the CT rate is 8%. Alcock Inc is a company with investment business producing taxable profits of £40,000 p.a.
- (2) Barbauld SA – resident in Narnia where the CT rate is 20%. Barbauld SA is a company with investment business producing profits of £2 million p.a.
- (3) Blake Inc – resident in Albion where the CT rate is 5%. Blake Inc makes nursery accessories and has profits of £750,000 p.a.

The CFC charge

If none of the exemptions above are met, a **CFC charge** (i.e. a charge to UK corporation tax) may arise.

However, the CFC charge only applies to **chargeable profits** (if any).

- **Chargeable profits =**
 - the **income** of the CFC
 - **not** chargeable gains
 - that has been **artificially diverted** from the UK
 - calculated using the UK tax rules.
- CFCs are regarded as having **no chargeable profits** (and therefore **no CFC charge**) if any of the following conditions are satisfied:
 - the CFC does not hold any assets or bear any risks under any arrangements/tax planning schemes intended to reduce UK tax
 - the CFC does not hold any assets or bear any risks that are managed in the UK
 - the CFC would continue in business if the UK management of its assets and risks were to cease

If there are chargeable profits, a CFC charge only applies to a UK corporate shareholder if:

- the **UK company owns at least a 25% interest** in the CFC,
- no CFC charge arises on individual shareholders.

If applicable, **the CFC charge** is calculated as:

	£
(UK company's share of the CFC profits × main rate of corporation tax) (see note below)	X
Less: Creditable tax	
DTR that would be available if the CFC were UK resident	(X)
UK corporation tax on income of CFC that is taxable in UK (if any)	(X)
Income tax suffered by the CFC on its income (if any)	(X)
	—
CFC charge	X
	—

Note: The UK company's share of profits is usually **apportioned based on the percentage of shares held** and the **main UK rate** of corporation tax is **always used** for this charge.

- The CFC charge is **added to the corporation tax liability** of the UK company holding the shares in the CFC.
- UK companies are required to self-assess their liability to the CFC charge.
- A clearance procedure exists for companies to check with HMRC how the rules will be applied in specific cases.



Test your understanding 4

Zetec Ltd, a UK company with taxable profits of £20,000 for the year to 31 March 2024, holds 90% of an overseas subsidiary resident in Maxia. The subsidiary falls within the definition of a CFC.

The overseas subsidiary has £600,000 of profits for the period, 75% of which are caught by the CFC legislation and stand to be charged. The tax payable in Maxia is 5%.

Show the effect of the CFC on Zetec Ltd's corporation tax payable for the year ended 31 March 2024.

5 Planning situations



An important professional skill to master in the ATX exam is the ability to evaluate and give advice on a number of different options, which may require you to consider overseas aspects of corporation tax.

You should be prepared to discuss the tax implications of two alternative strategies and give a reasoned recommendation on which may be the best.



Illustration 6 – Expansion overseas

You act as a tax advisor to Northanger Ltd, a UK company specialising in the manufacture and sale of kitchen appliances. Northanger Ltd has a 31 March accounting reference date and is registered for VAT making solely taxable supplies for VAT purposes.

The company has been very successful since its formation seven years ago and now has taxable total profits of £1 million each year. The board of directors are considering several opportunities for expansion. They have asked you to report on the taxation consequences of both of the possible projects they have under review.

The details of the two projects are as follows:

(1) **Buy a stake in Fridgco Ltd**

This is a small company which has developed a new food storage product. At present, Fridgco Ltd is wholly owned by Helena who is willing to sell Northanger Ltd a 60% stake in Fridgco Ltd for £350,000 although she is prepared to consider offers for a higher stake. Helena will continue to own the shares that she does not sell to Northanger Ltd.

Fridgco Ltd has made losses in the past although it is expected to be profitable in future. At 1 April 2024, the company had trading losses brought forward of £70,000, and it made a capital loss of £55,000 on the sale of its headquarters building on 1 June 2024.

Since that sale, the company has used rented office space in addition to its manufacturing plant. For the year to 31 March 2025, the company expects to make a trading loss of £48,000.

Helena is considering increasing the asking price of £350,000 to take account of the value of these losses.

Assume any share purchase will take place on 1 February 2025.

(2) **Set up a new branch to expand sales**

This branch could be located in the UK but as the directors are keen to expand exports, they feel it would be better to locate it overseas in the country of Bajoria, a country which has no double tax treaty with the UK.

The branch operation is expected to be loss making initially and then produce profits of £200,000 per annum. Components would be shipped from the UK and sold through the branch. The Bajorian tax system operates in a similar way to the UK and levies tax on branch profits at 22%.

One of the directors has raised the possibility of operating in Bajoria through a company rather than a branch.

Write a report to the board of directors which covers the tax consequences of these two projects. Include any suggestions that you consider would improve the company's tax position.

Assume that FY2023 rates and allowances continue into the future.

Solution

Report

To: The board of directors

From: An Advisor

Subject: Tax consequences of two new investments

Buy stake in Fridgco Ltd

(1) Buy a 60% stake in Fridgco Ltd

This will have the following tax consequences:

The company will be an associated company for the whole of the accounting period of purchase (i.e. the year ended 31 March 2025).

The limits for corporation tax will be divided by two, but this will have no effect on the rate of tax paid by Northanger Ltd as it already pays tax at the main rate. However, the £1.5 million corporation tax profits threshold will also be halved to £750,000. With profits of £1 million, Northanger Ltd will have to start paying tax by instalments but not until year ended 31 March 2026.

Northanger Ltd and Fridgco Ltd can join a VAT group. This will be useful if there is to be much trading between the two companies, as supplies within the group are ignored for VAT.

Any dividends paid by Fridgco Ltd to Northanger Ltd will be exempt for Northanger Ltd and will not be included in augmented profits.

No group relief or capital gain advantages are available with a 60% stake. A consortium does not exist because this requires at least 75% of the shares to be owned by companies. Helena could incorporate a company to hold her shares and then a consortium would exist allowing Northanger Ltd to claim 60% of Fridgco Ltd's loss from 1 February 2025 onwards.

The purchase represents a change of ownership for Fridgco Ltd (more than half the shares have changed hands). If there is a major change in the nature or conduct of trade within a five-year period commencing up to three years before the change in ownership, then the trading losses of £70,000 brought forward plus £40,000 losses accruing from 1 April 2024 to 1 February 2025 (10/12 of £48,000) will lapse and will not be available to carry forward against future profits.

Even if there is no major change in the nature or conduct of trade the losses will not be able to be used by Northanger Ltd for the next five years as there has been a change in ownership.

Provided Northanger Ltd holds the shares in Fridgco Ltd for at least 12 months, any capital gain on the sale of the shares will be exempt under the substantial shareholding rules.

(2) Increase purchase to at least 75%

If Northanger Ltd buys at least 75% of Fridgco Ltd, then all of the above consequences will occur but it will also be possible to create a group relief and capital gains group. This would enable group relief to be claimed by Northanger Ltd for Fridgco Ltd's losses from 1 February 2025.

£8,000 ($2/12 \times £48,000$) could be surrendered to use against Northanger Ltd's TTP for the year ended 31 March 2025.

It is not possible for Northanger Ltd to make use of Fridgco Ltd's trading losses brought forward as group relief for five years after Fridgco Ltd joins the group, nor can they make use of the capital losses brought forward. These are designated as pre-entry losses and can only be used by Fridgco Ltd against gains on assets it owned when it joined the group or purchased subsequently from third parties.

Advice – the company should negotiate with Helena to buy at least 75% of Fridgco Ltd. Any increased price as a result of the available losses should only be considered if there will be no major changes to the trade within five years of the sale (and there hasn't been any major change in the three preceding years).

Set up new branch to expand sales

(1) Set up overseas branch

The profits of an overseas branch are taxed in the UK as part of trading profits. The initial losses will be relievable against UK profits of Northanger Ltd.

The extra £200,000 profits that are expected would be subject to tax at 25% in the UK although credit would be given for the 22% tax payable in Bajoria.

Alternatively, once the branch is profitable, Northanger Ltd could make an irrevocable election to exempt branch profits in the UK. This would avoid the extra 3% tax in the UK (25% – 22%), but would mean that if further branch losses were made in the future they could not be used in the UK.

Any goods shipped from the UK to sell in Bajoria will be treated as exports and will be zero-rated supplies in the UK.

(2) **Set up an overseas company instead of branch**

If a company is set up instead of a branch then there will be no relief for the initial losses. They will remain in Bajoria.

When profitable, any profits paid up to the parent company will be in the form of a dividend and will be exempt in Northanger Ltd's computation of taxable profits. As Northanger Ltd will own 100% of the shares, the dividend will not be included in augmented profits for the purposes of determining the rate of corporation tax and whether the company is liable to pay tax by quarterly instalments.

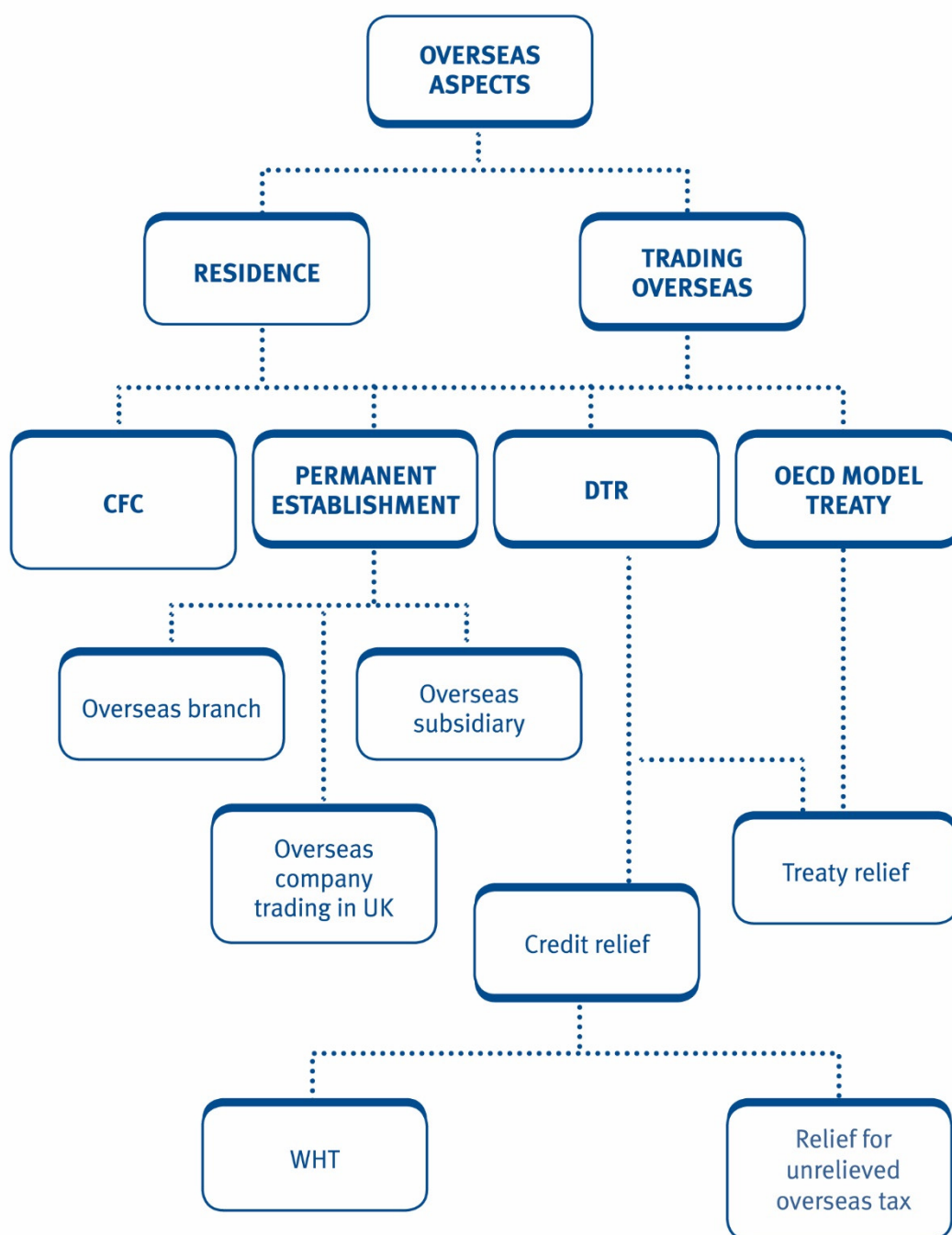
Although the tax rate in Bajoria is lower, this should not cause any problems under the CFC rules as tax payable in Bajoria is more than 75% of the UK equivalent tax.

A subsidiary in Bajoria will be an associated company, which will further reduce the corporation tax limits and payment threshold.

As the UK has no double tax treaty with Bajoria, any trading between UK companies of any size, and related companies in Bajoria may be subject to the transfer pricing rules. Northanger Ltd will have to ensure that any goods sold to the new subsidiary are sold at an arm's length price.

Advice – start the overseas operation as a branch to obtain relief for its expected losses. Once profitable it could be transferred to a company, or an election could be made to exempt branch profits in the UK.

6 Chapter summary



Test your understanding answers



Test your understanding 1

River plc

Corporation tax computation – year ended 31 March 2024

	UK	Overseas rent	Total
	£	£	£
Trading profit	900,000		900,000
Overseas rent (W1)		140,000	140,000
	<hr/>	<hr/>	<hr/>
TTP	900,000	140,000	1,040,000
	<hr/>	<hr/>	<hr/>
CT @ 25%	225,000	35,000	260,000
Less: DTR (W2)		(21,000)	(21,000)
	<hr/>	<hr/>	<hr/>
CT liability	225,000	14,000	239,000
	<hr/>	<hr/>	<hr/>

Workings

(W1) Gross overseas rent

	£
Rent received	119,000
Add: WHT ($15/85 \times £119,000$)	21,000
	<hr/>
Overseas rent	140,000
	<hr/>

(W2) DTR

	£
Lower of (i) Overseas tax suffered (W1)	21,000
(ii) UK CT ($25\% \times £140,000$)	35,000
	<hr/>



Test your understanding 2

Gold plc

Corporation tax computation – year ended 31 March 2024

	UK income £	Overseas rent £	Total £
Income (W1)	300,000	6,000	306,000
Less: QCDs	(100,000)	0	(100,000)
TTP	200,000	6,000	206,000
CT @ 25% (W2)	50,000	1,500	51,500
Less: DTR (W3)	0	(1,020)	(1,020)
CT liability	50,000	480	50,480

Workings

(W1) Gross overseas rental income

	£
Amounts received	4,980
Add: WHT ($£4,980 \times 17/83$)	1,020
Gross overseas income	6,000

(W2) Corporation tax rate

	£
TTP	206,000
Add: Dividend received	56,800
Augmented profits	262,800

As Gold plc owns < 50% of the overseas company, the overseas dividend will be included in augmented profits.

The overseas company is not an associated company; therefore, the full limits apply. With augmented profits greater than £250,000 the main rate applies.

(W3) DTR on overseas rental income

	£
Lower of:	
Overseas tax suffered (W1)	1,020
UK CT on overseas income	1,500



Test your understanding 3

Wordsworth Ltd

- (1) Alcock Inc will be exempt from the CFC charge as it has taxable profits below £50,000 (the low profits limit for non-trading profits).
- (2) Barbould SA should also be exempt from the CFC charge as it is resident in a country where the CT payable is likely to be at least 75% of the tax that would be payable in the UK if the company were UK resident (tax exemption).
- (3) Blake Inc appears not to satisfy any of the exemptions, so there may be a CFC charge. However, the charge will only apply if it has any 'chargeable profits'.



Test your understanding 4

Zetec Ltd

The UK corporation tax payable by Zetec Ltd is:

	£	£
Taxable total profits		20,000
		<hr/>
Corporation tax at small profits rate (19% × £20,000)		3,800
Extra UK tax on CFC profits:		
UK tax on apportioned profits at main rate (25% × 90% × 75% × £600,000)	101,250	
Less: DTR for tax suffered in Maxia (5% × 90% × 75% × £600,000)	(20,250)	
	<hr/>	81,000
		<hr/>
Total UK corporation tax payable		84,800
		<hr/>

CGT: Computations and stamp duty land tax

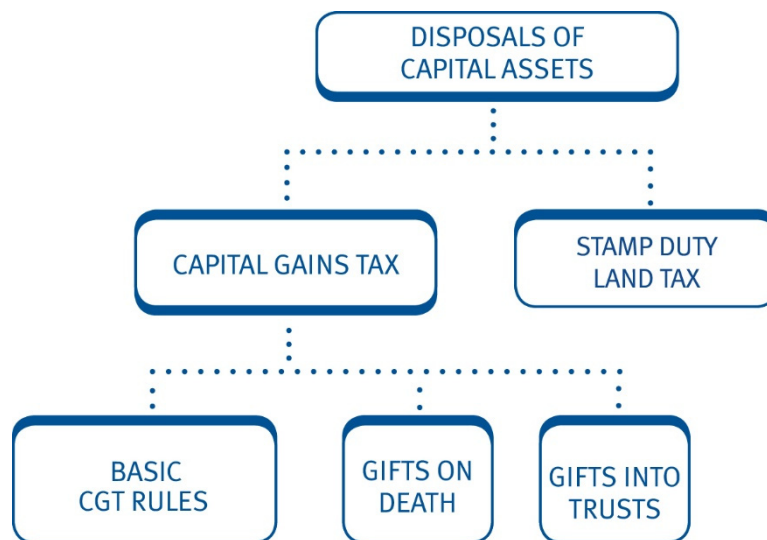
Chapter learning objectives

Upon completion of this chapter you will be able to:

- compute the capital gains tax payable, given a variety of basic transactions for an individual including the treatment of losses
- evaluate the use of capital losses in the year of death
- advise on the tax effect of making negligible value claims
- advise on the capital gains tax implications of transfers of property into trust
- identify the property in respect of which stamp taxes are payable
- advise on the stamp taxes payable on transfers of land
- advise on the use of exemptions and reliefs in deferring and minimising stamp taxes: identify transfers involving no consideration.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. This could include chargeable gains and capital gains tax. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This and the following three chapters deal with the way in which individuals are subject to capital gains tax on their chargeable gains.



Much of this chapter is a revision of the rules covered in TX. A brief reminder of TX content is given, and revision examples are provided to check your retention of the required TX knowledge.

The main new topics introduced include the implications of putting assets into a trust and stamp duty land tax.

1 Basic capital gains tax rules

The scope of capital gains tax

Capital gains tax (CGT) is charged on gains arising from **chargeable disposals** of **chargeable assets** by **chargeable persons**.

A reminder of these important terms is given below.

A **chargeable person** includes individuals, companies and business partners in a partnership.

This chapter covers the CGT implications of disposals by individuals.

Chargeable disposal	Exempt disposal
<p>The following are treated as chargeable disposals:</p> <ul style="list-style-type: none"> (i) sale or gift of the whole or part of an asset (ii) exchange of an asset (iii) loss or total destruction of an asset (iv) receipts of a capital sum derived from an asset, for example: <ul style="list-style-type: none"> • compensation received for damage to an asset • receipts for the surrender of rights to an asset. 	<p>Exempt disposals include:</p> <ul style="list-style-type: none"> (i) disposals as a result of the death of an individual (ii) gifts to charities.
Chargeable assets	Exempt assets
<p>All forms of capital assets, wherever situated, are chargeable assets.</p> <p>Common examples include:</p> <ul style="list-style-type: none"> • Freehold land and buildings • Goodwill • Short lease • Long lease • Unquoted shares • Quoted shares • Unit trusts • Chattels bought and sold > £6,000. <p>(Chattels are tangible movable assets e.g. furniture, plant and machinery)</p>	<p>Exempt assets include:</p> <ul style="list-style-type: none"> • Motor vehicles (including vintage cars) • Main residence (subject to occupation) • Cash • Wasting chattels (e.g. racehorses and greyhounds) • Chattels bought and sold < £6,000 • Investments held within an individual savings account (ISA) • Qualifying corporate bonds (QCBs) • Gilt-edged securities • National savings certificates • Shares in a venture capital trust (VCT) • Endowment policy proceeds • Foreign currency for private use • Receivables • Trading inventory • Prizes and betting winnings.

The basis of assessment

Individuals are assessed to CGT:

- under self-assessment
- on actual disposals of capital assets between 6 April and 5 April.



The date of disposal

Determining the date of disposal is very important as it determines the tax year in which a chargeable gain is assessed or an allowable loss arises.

Event	Date of disposal
Lifetime transfer: <ul style="list-style-type: none"> • normally • conditional contract 	<ul style="list-style-type: none"> • Date of the contract/agreement to transfer the asset (not necessarily the same date as the actual date of transfer) • Date when all of the conditions are satisfied and the contract becomes legally binding
Transfers on death:	<ul style="list-style-type: none"> • Date of death of the individual (although no CGT payable on death) – see section 3



Illustration 1 – Date of disposal

Aya decided to sell an investment property to her friend Khaled. Contracts were exchanged on 13 February 2024 with an intended completion date of 25 March 2024, but the contract was conditional on planning permission being obtained.

Planning permission was granted on 29 March 2024 and completion took place on 8 April 2024.

State, with reasons, the tax year in which the gain will be taxed.

Solution

Aya will be taxed on the gain in the tax year 2023/24.

The completion date is not relevant. The sale agreement was a conditional contract and the disposal takes place when the condition is satisfied (i.e. 29 March 2024).

The capital gains tax computation

- Step 1** Calculate the chargeable gain/allowable loss arising on the disposal of each chargeable asset separately
- Step 2** Consider the availability of any CGT reliefs (Chapter 9)
- Step 3** Calculate the net chargeable gains arising in the tax year = (capital gains less allowable losses)
- Step 4** Deduct the annual exempt amount
- Step 5** Deduct capital losses brought forward = taxable gains
- Step 6** Calculate the CGT liability for the tax year.
- Step 7** Deduct payments on account for UK residential property disposals to calculate the CGT payable for the tax year.

Pro forma capital gains tax payable computation – 2023/24

	£
Net chargeable gains for the tax year	X
Less: Annual exempt amount (AEA)	(6,000)
	<hr/>
	X
Less: Capital losses brought forward (see below)	(X)
	<hr/>
Taxable gains	X
	<hr/>
CGT liability (taxable gains × appropriate rate)	X
Less: Payments on account	(X)
	<hr/>
CGT payable	X
	<hr/>

The calculation of the individual chargeable gains/allowable losses

	Notes	£
Consideration	1	X
Less: Incidental costs of sale	2	(X)
		<hr/>
Net disposal proceeds		X
Less: Allowable expenditure		
– Acquisition cost	3	(X)
– Incidental costs of acquisition	2	(X)
– Enhancement expenditure		(X)
		<hr/>
Chargeable gain/(allowable loss)		X(X)
		<hr/>

Notes

- (1) The consideration is normally:
 - **disposal proceeds actually received** for a sale to an unconnected person
 - **market value** for gifts and sales to connected persons
 - if it is the disposal of a building or structure on which SBAs have been claimed then the **SBAs claimed should be added to consideration**.
- (2) Allowable incidental costs of sale and acquisition include:
 - legal expenses
 - valuation fees, estate agent fees, auctioneer's fees
 - advertising costs
 - stamp duty (on shares) and stamp duty land tax (on land and buildings).
- (3) The acquisition cost is normally:
 - **actual cost** if the asset was purchased
 - **market value** when acquired if the asset was gifted
 - **probate value** at the date of the donor's death if the asset was inherited.

Capital losses

Current year capital losses

Capital losses arising on assets in the current tax year are set off against chargeable gains, arising in the same tax year:

- to the maximum possible extent
- they cannot be restricted to avoid wasting all or part of the AEA.

Any unrelieved capital losses are carried forward to offset against gains in future years.

Brought forward capital losses

Brought forward losses

- are set against chargeable gains **after** any current year losses and the AEA have been deducted
- any unused loss is then carried forward for use in the future.



Negligible value claims

If the value of an asset becomes negligible for whatever reason, the owner may claim relief.

The owner is then treated as having disposed of, and immediately reacquired, the asset at its negligible value. This treatment crystallises a capital loss.

The deemed disposal is treated as occurring:

- at the date of the claim, or
- up to two years before the start of the tax year in which the claim was made.

The back dating of the capital loss applies only if the asset was actually of negligible value at both the date of the claim and the earlier date.

Annual exempt amount

An individual is entitled to an annual exempt amount (AEA) each tax year.

- For the tax year 2023/24 the AEA is £6,000.
- If the AEA is not utilised in any particular tax year, then it is wasted.

Computation of CGT payable

CGT is payable on the taxable gains arising in a tax year as follows:

- The rate of CGT is dependent upon the amount of a taxpayer's total taxable income (i.e. after deduction of the personal allowance) and the type of asset being disposed of.
- Taxable gains are taxed **after** taxable income (i.e. as the top slice) but do not combine income and gains in one computation.
- Generally where total taxable income and gains are less than the upper limit of the basic rate band, CGT will be at 10%.
- Generally to the extent that any gains (or any part of gains) exceed the basic rate band they will be taxed at 20%.
- If the basic rate band is extended due to gift aid donations or personal pension contributions the extended basic rate band will also be used to establish the rate of CGT.
- Any unused income tax personal allowance cannot be used to reduce taxable gains.

Rates of CGT

CGT is paid at the normal rates, unless the gain arises on the disposal of a residential property.



A **residential property** is one that people normally live in whereas a commercial property is one that is used by a business.

	Falling in basic rate band	In excess of basic rate band
Normal rates	10%	20%
Residential property rates	18%	28%

In practice, a taxpayer's main residential property (i.e. the taxpayer's home) will be exempt from CGT under the private residence relief rules (PRR). However, where the gain on the disposal of a residential property is not fully exempt (e.g. on an investment property which is let out) it is taxed at the higher rates.

Offset of AEA and capital losses

Taxpayers can offset the AEA and capital losses against whichever gains they choose.

- In order to maximise the reliefs:
 - offset firstly against **residential property gains**, as they are taxable at higher rates than other gains.

The unused basic rate band may also be offset however the taxpayer chooses.

- The tax saving will be the **same** regardless of the gains against which it is used (as switching gains taxed at 28% to 18% or switching gains taxed at 20% to 10% produces the same result).
- However, for consistency in this text the unused basic rate band has been used firstly against other gains.

Payments on account for UK residential property disposals

Disposals of UK residential property:

- must be reported to HMRC within **60 days** of completion, and
- the relevant CGT liability paid at the same time.

A UK land return is submitted through an online system together with the payment of the associated CGT.

There is no need to submit a UK land return if there is no CGT due.

- This would be the case where
 - the gain is covered by private residence relief, or
 - is less than the AEA, or
 - the property is disposed of at a loss.

Calculation of CGT payment on account

- The rate of CGT is determined using an estimate of the individual's income at the point of the disposal, i.e. estimating how much of the BRB will be remaining.
- Brought forward losses and current year capital losses realised **prior** to the UK residential property disposal may be offset against the gain when calculating the tax due through the online system.

The calculation of payments on account where there is more than one residential property disposal during the tax year is **not examinable**.

Inclusion in final self-assessment tax return

All disposals made during a tax year (including any UK residential property disposals) must be included in the final tax return.

- Deduct CGT payments on account from the CGT liability to reach the final amount of CGT payable.
- If a repayment is due, this will be claimed when the self-assessment tax return for the tax year is submitted.



A payment on account of CGT has nothing to do with the normal self-assessment payments on account which are due by 31 January during the tax year, and 31 July following the end of the tax year.



Test your understanding 1

Fanta sold the following assets in the tax year 2023/24:

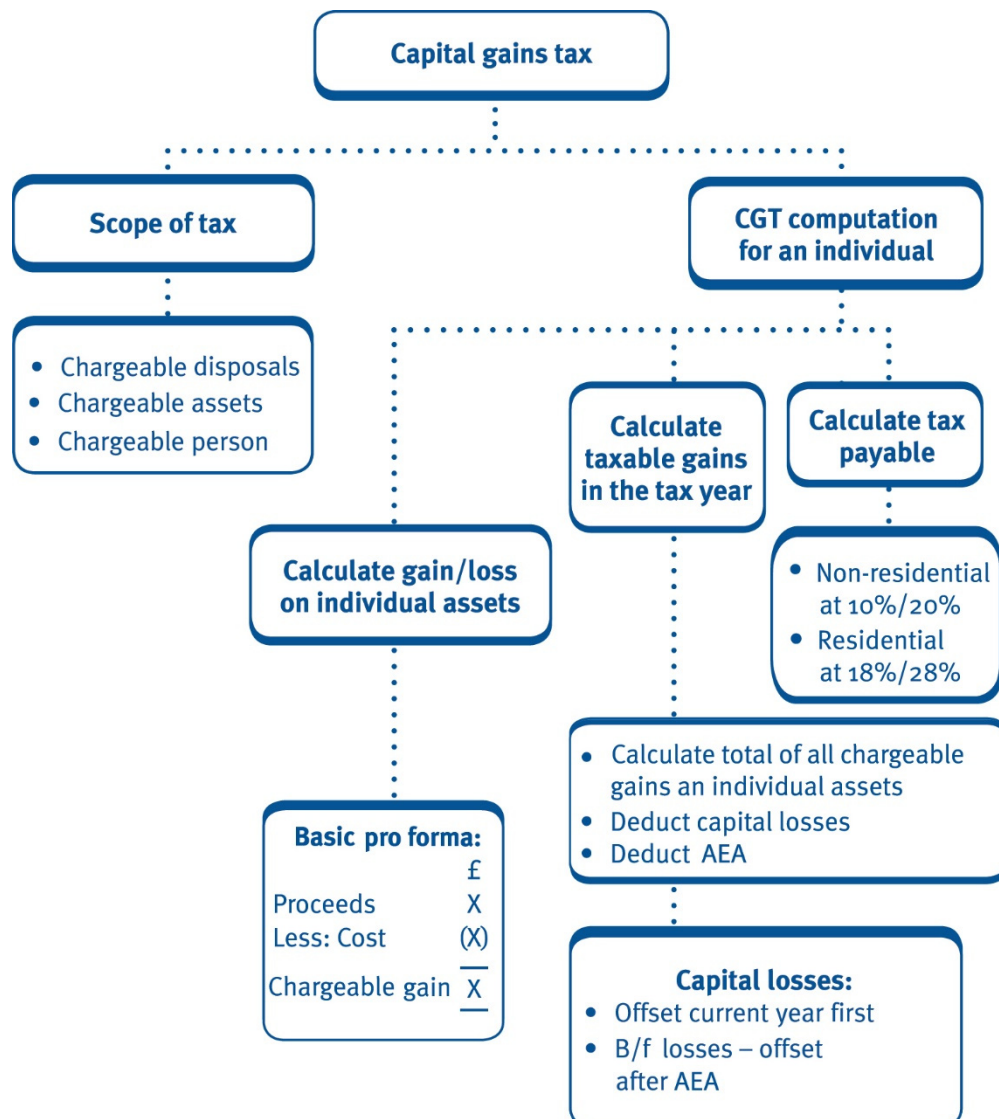
- a residential investment property in Wales on 1 July 2023 for £650,000. She had acquired the building for £80,000 in June 2008 and had extended it at a cost of £30,000 in June 2010
- a painting on 1 August 2023 for £20,000, incurring auctioneer's fees of 10%. She had acquired the painting for £35,000 in April 2010
- a painting on 1 December 2023 for £80,000. The painting had been purchased on 1 December 2007 for £7,000.

Fanta had capital losses brought forward of £22,000. Fanta's only source of income in the tax year 2023/24 was trading income of £40,270.

Tax of £142,360 has been paid in respect of the residential property.

Calculate Fanta's capital gains tax payable for the tax year 2023/24.

A summary of the basic CGT rules



2 The payment of capital gains tax

Payment under self-assessment

CGT is normally payable:

- under self-assessment
- in one payment along with the balancing payment of income tax (except for disposals of UK residential property, see above)
- 31 January 2025 for the tax year 2023/24.



3 Capital gains tax on the death of an individual

The CGT consequences of the event of death

CGT is a 'lifetime tax'. Transfers on the death of an individual are therefore exempt disposals.

The CGT consequences of death are as follows:

- no capital gain or allowable loss arises as a result of the death
- the beneficiaries inherit the assets of the deceased and are deemed to acquire the assets:
 - with a base cost equivalent to the market value of the asset at the date of death (i.e. at probate value)
 - on the date of death, regardless of the date they actually receive the asset.

Note that whilst the increase in the capital value of an asset from acquisition to the date of death is not liable to CGT, there are inheritance tax (IHT) implications arising from the death of an individual (see later chapters).



Illustration 2 – Death of an individual

Giovanni bought an asset on 16 August 1998 for £300 and died on 10 December 2023 when the asset was worth £1,000,000. The asset is left to Gorka, his son. The executors gave the asset to Gorka on 24 March 2024.

Gorka sold the asset for £1,200,000 on 16 March 2025.

Explain the CGT consequences arising from the above events.

Solution

Giovanni's death

On Giovanni's death the following consequences arise:

- the increase in the value of the asset of £999,700 (£1,000,000 – £300) is exempt from CGT
- Gorka is deemed to acquire the asset at a base cost of £1,000,000 on 10 December 2023
- the fact that Gorka actually received the asset on 24 March 2024 is not relevant.

Sale of asset by Gorka

On the disposal of the asset by Gorka: a chargeable gain of £200,000 (£1,200,000 – £1,000,000) will arise.

Valuation of quoted shares on death

Note that the probate value of quoted shares (and therefore the base cost for CGT purposes) is:

- where a valuation was obtained on death
= the lower of the quarter up or the average marked bargains method using the IHT valuation rules (see Chapter 11)
- where a valuation was not obtained on death
= the mid-price value using the CGT valuation rules (see Chapter 8)
(this will be the case where the value of the estate falls below the IHT threshold and no IHT was payable).

Tax planning

It is possible to change the terms of an individual's will after the individual's death by entering into a deed of variation.

A deed of variation can have both CGT and IHT consequences. See Chapter 12 for details.

Capital losses in the year of death

Losses in excess of gains arising in the tax year of death can be:

- carried back three tax years
- on a LIFO basis
- and set against the remaining net gains in those years.

In the carry back years the offset is after deducting the AEA. As a result of carrying back losses, a repayment of CGT will be obtained from HMRC. This repayment will be an asset at the date of the individual's death, to be included in the individual's death estate for IHT (see Chapter 11).

Transfer of ISA on death

On death, an ISA allowance equal to the deceased individual's ISA savings can be claimed by the surviving spouse or civil partner (Chapter 18).

As a result, the deceased individual's ISA savings will retain their beneficial tax treatment (i.e. exemption from income tax and capital gains tax) in the future, in the hands of the surviving spouse or civil partner.



4 Transfers of assets into a trust

An individual may gift assets into a trust fund during the individual's lifetime or on death under the provisions of the individual's will.

The following CGT consequences will arise in respect of a gift into a trust:

Lifetime gift by the donor	Gift on death of the donor
<ul style="list-style-type: none"> Chargeable disposal at full market value Gift holdover relief is available on any asset (Chapter 9) as there is an immediate charge to IHT 	<ul style="list-style-type: none"> No chargeable gain or allowable loss arises as a result of the death The trustees acquire the assets at probate value on the date of death

Trusts are covered in more detail in Chapter 13.



5 Stamp duty land tax

There are two types of stamp taxes

	Transactions
Stamp duty	Transfers of shares and other marketable securities
Stamp duty land tax	Transfers of UK land and property

Stamp duty is covered in detail in Chapter 8. This section covers stamp duty land tax.

Stamp duty land tax (SDLT) is payable on transactions involving land, unless the transaction is specifically exempt.

SDLT is payable:

- by the purchaser
- on the transfer of land and property, lease premiums and rent paid under leases
- in England and Northern Ireland
- based on the value of the property transferred and the type of property.

SDLT is charged on premiums paid in respect of a lease and the rent paid on leases. However, this aspect of SDLT is not examinable.

In Scotland and Wales, land and buildings transaction tax (LBTT) and land transaction tax (LTT) respectively, have replaced SDLT, however LBTT and LTT are not examinable.

Purchases of UK non-residential land and property

SDLT is charged on non-residential property as follows:

Value

£150,000 or less	0%
£150,001 – £250,000	2%
£250,001 and above	5%

SDLT is calculated on a stepped basis on the value falling within each band.



The rates payable are included in the tax rates and allowances provided in the examination.

SDLT is charged at different rates on residential property. However, SDLT on residential property is not examinable.



Consideration paid

The consideration subject to duty is any money or money's worth provided by the purchaser.

Where the consideration is unascertainable at the time of the transaction it must be estimated. Any changes to the consideration caused by future events must be notified to HMRC and duty will be paid or repaid as appropriate.



Illustration 3 – Stamp duty land tax

Peter purchased the following in September 2023 in two unrelated transactions.

- (a) A retail shop costing £140,000.
- (b) A freehold office building costing £200,000.

Calculate the amount of stamp duty land tax payable.

Solution

- (a) SDLT on the purchase of a shop: £Nil, as the price is \leq £150,000
- (b) SDLT on the purchase of a freehold office:

£		£
150,000	× 0%	0
50,000	× 2%	1,000
<hr/>		
200,000		
<hr/>		
SDLT payable		<hr/> 1,000 <hr/>



Test your understanding 2

Stacey purchased a non-residential property for £420,000.

Stacey then sold some non-residential land to Beth for £145,000.

Assuming both transactions took place in the tax year 2023/24, calculate the amount of SDLT payable and state who is liable to pay on each transaction.



Exemptions from stamp duty land tax

There is no SDLT payable if the transfer is exempt.

The main exempt transfers are as follows:

- gifts, provided no consideration is given
- divorce arrangements
- variation of a will
- transfers of assets between members of a 75% group of companies.



Transfers between 75% companies

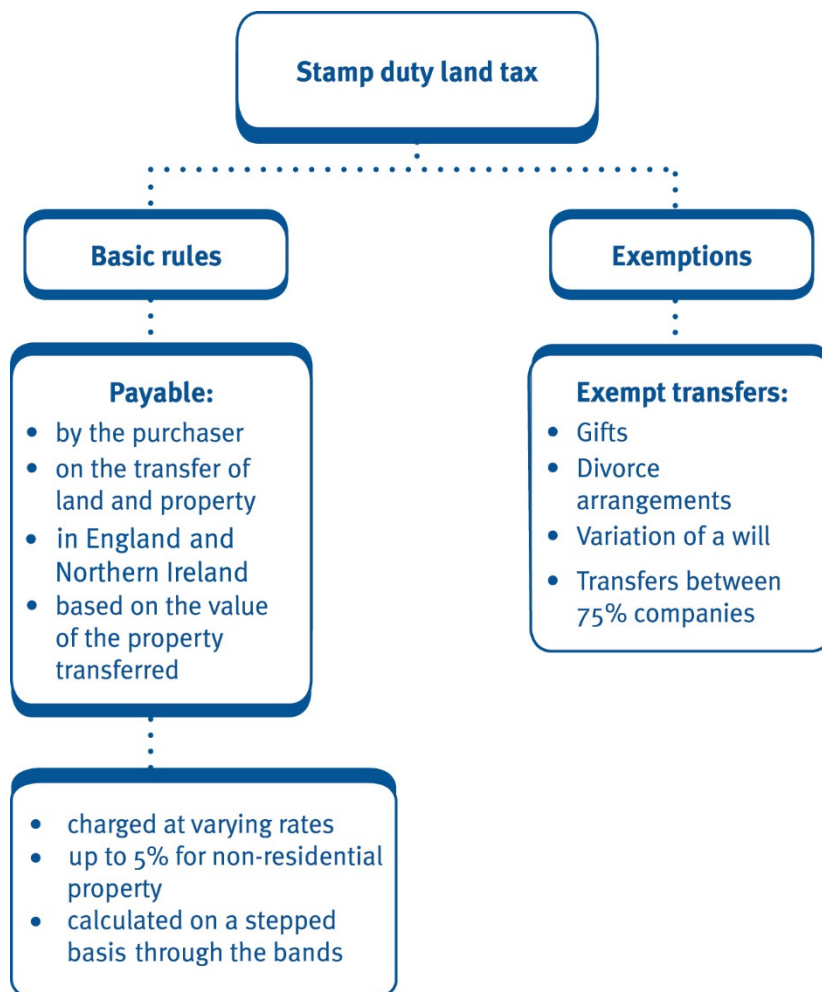
There is no charge to stamp duty or SDLT where assets are transferred between two group companies.

Two companies are in a group where one is a 75% subsidiary of the other or they are both 75% subsidiaries of a third company.

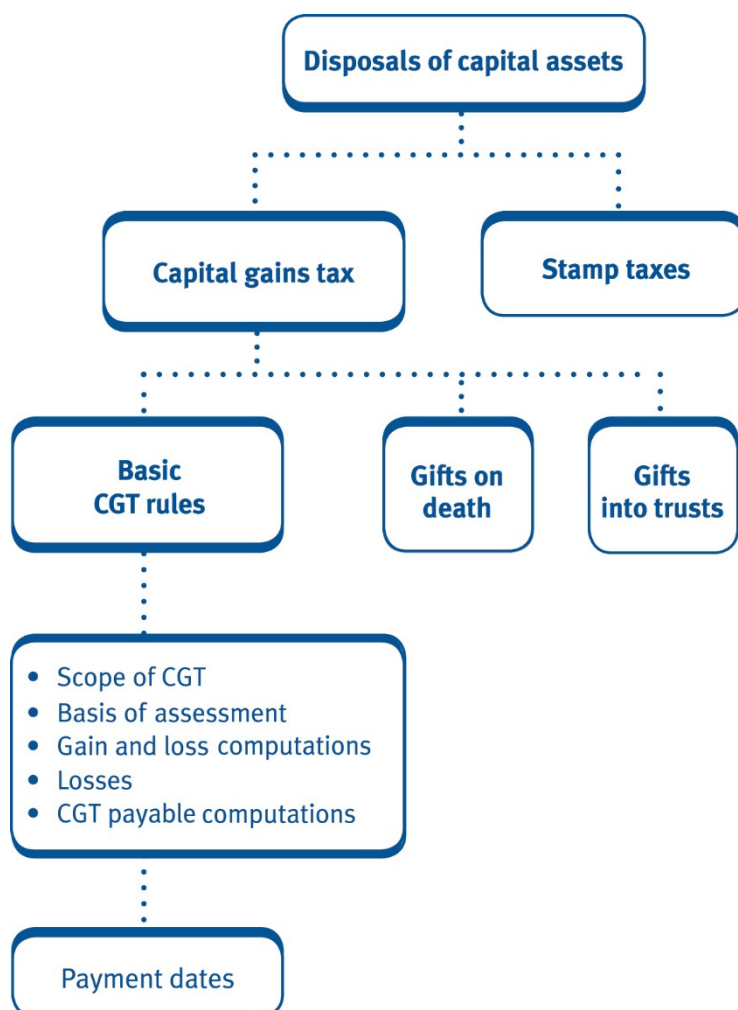
This relief is not available where, at the time the assets are transferred, arrangements exist for the purchasing company to leave the group.

Any relief given in respect of SDLT is withdrawn, with duty becoming payable, if the transferee company leaves the group within three years of the transfer whilst still owning the land transferred.

Summary



6 Chapter summary



Test your understanding answers



Test your understanding 1

Fanta

Capital gains tax computation – 2023/24

		Other gains	Residential property	Total
	£	£	£	£
Investment property				
Disposal proceeds	650,000			
Less: Cost of acquisition	(80,000)			
Enhancement expenditure	(30,000)			
			540,000	540,000
Painting				
Disposal proceeds	80,000			
Less: Cost of acquisition	(7,000)			
		73,000		73,000
Painting				
Disposal proceeds	20,000			
Less: Allowable selling costs (10%)	(2,000)			
Net proceeds	18,000			
Less: Cost of acquisition	(35,000)			
			(17,000)	(17,000)
Net chargeable gains arising in tax year		73,000	523,000	596,000
Less: AEA			(6,000)	(6,000)
Capital losses brought forward			(22,000)	(22,000)
Taxable gains		73,000	495,000	568,000

	£			£
Basic rate (W)	10,000	× 10%	(Other gains)	1,000
Higher rate	63,000	× 20%	(Other gains)	12,600
	<hr/>			
	73,000			
Higher rate	495,000	× 28%	(Residential)	138,600
	<hr/>			
	568,000			
	<hr/>			
Capital gains tax liability				152,200
Less: Tax paid through online system				(142,360)
				<hr/>
Capital gains tax payable				9,840
				<hr/>
Note: Losses and the AEA are allocated to residential property gains in preference to other gains as they are subject to CGT at higher rates.				
Working: Basic rate band remaining				
	£			£
Basic rate band				37,700
Trading income	40,270			
Less: PA	(12,570)			
	<hr/>			
Taxable income				(27,700)
				<hr/>
Basic rate band remaining				10,000
				<hr/>



Test your understanding 2

Stacey

£		£
150,000	× 0%	0
100,000	× 2%	2,000
170,000	× 5%	8,500
<hr/>		
420,000		
<hr/>		
SDLT payable		<hr/> 10,500 <hr/>

Beth

Under £150,000 = £0

CGT: Variations to computations

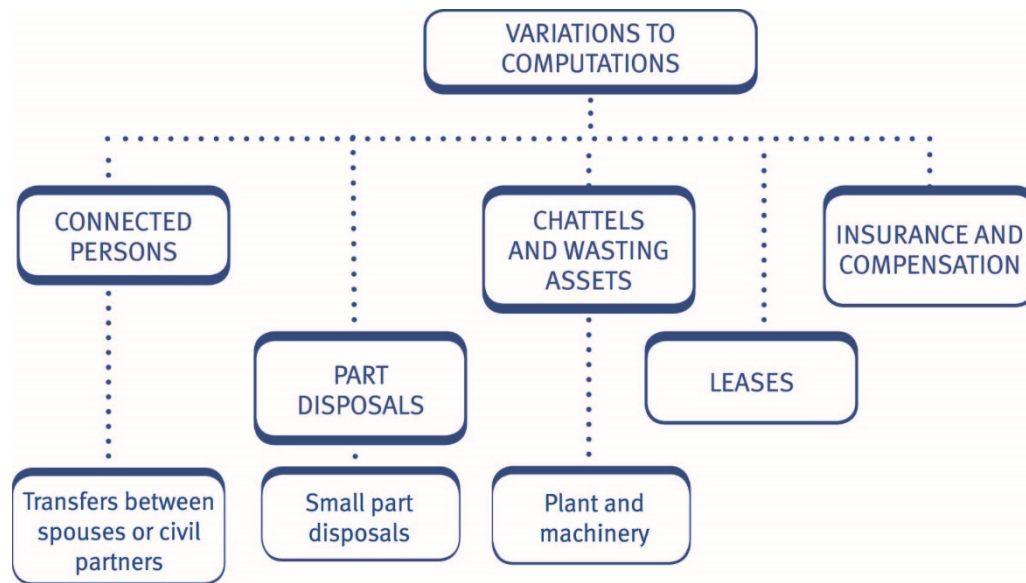
Chapter learning objectives

Upon completion of this chapter you will be able to:

- determine the tax implications of independent taxation and transfers between spouses
- identify connected persons for capital gains tax purposes and advise on the tax implications of transfers between connected persons
- advise on the impact of dates of disposal
- extend the explanation of part disposals to include small part disposals of land
- determine the gain on the disposal of leases and wasting assets
- extend the explanation of the treatment of assets damaged, lost or destroyed to include capital sums received.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

The basic pro forma for calculating chargeable gains/(allowable losses) can be used for all disposals of any assets. However, in certain circumstances, additional special rules are needed.



This chapter is mainly revision of topics covered at TX. A brief reminder of TX content is given and revision examples are provided to check your retention of the required TX knowledge.

The main new topics introduced at ATX include tax planning aspects, connected persons and the assignment of leases.



1 The treatment of disposals between connected persons



The definition of connected persons

An individual is connected with his, her or their:

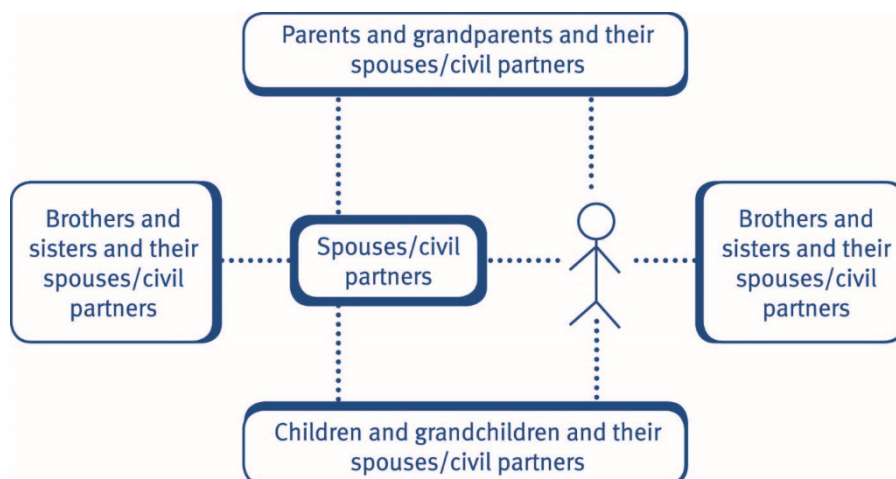
- spouse or civil partner
- relatives (and their spouses or civil partners)
- spouse's or civil partner's relatives (and their spouses or civil partners)
- business associates
- a company they control.

The term '**relative**' means:

- brothers and sisters
- parents, grandparents and other ancestors
- children, grandchildren and other descendants.

The term '**business associate**' means:

- partners in business
- a business partner's spouse or civil partner
- relatives of the business partner.



The implications of disposals to a connected person

The CGT implications of making a disposal to a connected person **other than to the spouse or civil partner** are as follows:

Consideration used in the gain computation	<ul style="list-style-type: none"> • Market value at the date of the disposal (regardless of any consideration actually received).
Capital loss on a disposal to a connected person	<ul style="list-style-type: none"> • Can only be set off against current or future gains arising from disposals to the same connected person.

The implications of transfers between spouses or civil partners

Inter spouse transfers and transfers between civil partners are treated as: 'no gain/no loss' (NGNL) transfers

- The transfer is deemed to take place for a consideration which will give rise to neither a gain nor a loss, regardless of any actual consideration which may have been received.
- The transferor is therefore deemed to have disposed of the asset at its acquisition cost.

Note that these rules only apply until the end of a tax year in which the couple are living together (i.e. not separated).



Test your understanding 1

Motsi bought a seaside flat in Cornwall in December 1999 for £23,600 to use when she was on holiday from work. The flat has never been used as Motsi's main residence and does not qualify as furnished holiday accommodation.

In November 2023 Motsi decided to gift the flat which was worth £175,000.

- (a) **Calculate the chargeable gain arising on the gift of the flat assuming Motsi gifted the flat to:**
 - (i) her sister
 - (ii) her civil partner.
- (b) **Calculate the chargeable gain arising if the sister sells the flat in May 2024 for £200,000.**
- (c) **Calculate the chargeable gain arising if the civil partner sells the flat in May 2024 for £200,000.**

Married couples and civil partners – tax planning

A married couple and civil partners can use the no gain/no loss (NGNL) transfer rule to their advantage to save tax in some situations.



For the purposes of this section reference made to spouses also applies to partners in a civil partnership.

Utilising capital losses

Capital losses cannot be transferred between spouses.

Where one spouse will make a chargeable gain and the other a capital loss, it is possible to transfer the asset (or a part share in an asset) before the disposal on a NGNL basis, so one spouse makes both disposals and the loss can be used to reduce the chargeable gain.

Utilising annual exempt amounts

Each spouse is entitled to an annual exempt amount (AEA).

The couple can also utilise the NGNL transfer rule to ensure each spouse fully utilises:

- any capital losses brought forward from earlier years
- the AEA (£6,000 for the tax year 2023/24).

Utilising basic rate band

Generally taxable gains in the basic rate band are only taxed at 10%, whereas taxable gains in the higher rate band are taxed at 20%.

Where residential property is sold and the resulting gain is not fully exempt under PRR, the gain is taxed at 18% in the basic rate band and 28% in the higher rate band (see Chapter 6).

If any taxable gains would remain after utilising capital losses and AEAs, the couple can use the NGNL transfer rule before the ultimate disposal to ensure that these gains are left with the spouse paying tax at the lowest rate.

Delaying disposals until the following tax year

Tax saving

- If the AEA has already been utilised in a particular tax year, delaying the disposal of an asset until the following year will:
 - allow the offset of the later year's AEA against any gain arising
 - thereby saving tax on a further £6,000.
- If the individual is a basic rate tax payer, and taxable income is lower in a subsequent tax year, delaying the disposal would mean that:
 - more of the basic rate band would be available, and
 - therefore more of the resulting taxable gain could be taxed at 10% (or 18% if it is a residential property gain).

Cash flow advantage

- Gains realised on disposals up to and including 5 April 2024 are taxable in the tax year 2023/24 and the associated CGT is payable by 31 January 2025, with the exception of disposals of UK residential property where the tax is always due within 60 days of completion.
- If disposals later in the tax year can be delayed until 6 April 2024 or later:
 - the gain is realised in the tax year 2024/25, and
 - any CGT is payable one year later, by 31 January 2026.

Selling assets in tranches

Where assets can be split and sold piecemeal (e.g. shares), selling them in tranches in different tax years can allow the use of more than one AEA and a lower total taxable gain overall.

Impact on income tax

Inter spouse transfers of capital assets do not give rise to a CGT liability. However, care should be taken in advising which assets are transferred between spouses.

A transfer of:

- non-income generating assets (e.g. a painting, antiques) will have no impact on the couple's income tax position
- income generating assets (e.g. shares, letting property) will result in the income being taxed on the recipient spouse in the future.

The couple should ensure that assets generating income are owned by the spouse paying income tax at the lowest rate.

The couple can jointly own assets in equal or unequal proportions. However, it is important when giving advice to note that:

- even if owned in unequal proportions, any income generated from jointly owned assets will normally be split 50:50 between the spouses
- unless the couple make a joint election to split the income based on beneficial ownership (Chapter 16).

Exceptions are:

- dividends from shares in a close company (Chapter 24), which are always split on a beneficial ownership basis
- interest from joint bank accounts, which is always split 50:50.



Test your understanding 2

Tomasz owns a residential investment property that would realise a chargeable gain of £30,000 if sold in the tax year 2023/24. Tomasz has taxable income of £60,000.

His wife, Vanessa, has capital losses brought forward of £11,800. Vanessa has taxable income of £16,200.

Explain the tax planning measures you would recommend and the taxation effect with supporting calculations as necessary.

2 Part disposals

The problem with part disposals is identifying how much of the original cost of the asset relates to the part disposed of.

A reminder of the rules is given in supplementary reading and is summarised in the diagram in section 5.



Part disposals – the allowable expenditure calculation

The appropriate proportion is calculated as follows:

$$\text{Cost} \times A/(A + B)$$

Where: A = gross consideration of the part disposed of

B = market value of the remainder (at the time of the part disposal)

The appropriate proportion formula is applied to:

- the original cost (including any incidental acquisition costs)
- enhancement expenditure where the enhancement applies equally to the whole asset.

Note that if the enhancement relates:

wholly to the part disposed of:	<ul style="list-style-type: none"> • deduct in full in the part disposal computation.
wholly to the part retained:	<ul style="list-style-type: none"> • do not deduct any in the part disposal computation.



Small part disposals of land and buildings

Where the proceeds received on the part disposal of land and buildings are 'small', a part disposal gain arises unless an election is made.

The effect of making an election is that:

- there will be no part disposal at the time
- the gain is deferred until the disposal of the remainder
- the gain is deferred by deducting the proceeds received on the small part disposal from the original cost of the asset
- the base cost of the part retained is therefore reduced and the gain arising on the subsequent disposal of the remainder will be higher.



Definition of 'small'

Proceeds of the part disposal:

- < 20% of the value of land and buildings before the part disposal, and
- total of all land sales in the tax year < £20,000.



Test your understanding 3

Edward bought a five-hectare plot of land for £30,000 in March 2013 for investment purposes.

In July 2023, Edward sold one hectare of the land for £9,500. The remaining four hectares were worth £80,000.

In September 2024 Edward sold the remaining four hectares for £135,000.

Calculate the chargeable gains arising from the disposals of the land assuming:

- (i) an election is made to defer the gain on the part disposal.
- (ii) an election is not made.

3 Chattels and wasting assets

A reminder of the special rules for calculating the gain or loss arising on a chattel or a wasting asset is given below and is summarised in the diagram in section 5.



Chattels

A chattel is defined as tangible movable property.

Chattels may be wasting assets (i.e. with a predictable life not exceeding 50 years) or non-wasting.

The CGT consequences of chattels can be summarised as follows:

Wasting chattels	Non-wasting chattels
Expected life 50 years or less	Expected life more than 50 years.
Examples: racehorse greyhound boat, caravan	Examples: antiques jewellery paintings
<ul style="list-style-type: none"> Exempt. Exception: plant and machinery (see below). 	<ul style="list-style-type: none"> If bought and sold for £6,000 or less: <ul style="list-style-type: none"> exempt. If bought and sold for more than £6,000: <ul style="list-style-type: none"> chargeable in the normal way. Otherwise: special rules apply <ul style="list-style-type: none"> but not examinable at ATX.



Wasting chattels

Wasting assets have a predictable life of 50 years or less.

For CGT purposes, wasting assets can be split into three key categories.

- Chattels not eligible for capital allowances = exempt from CGT (see above).
- Chattels eligible for capital allowances (e.g. plant and machinery).
- Other wasting assets.

Plant and machinery

Plant and machinery is **always** deemed to be a wasting asset.

- Sold at a gain – normal calculations apply
- Sold at a loss – no gain/no loss as relief for loss is given in the capital allowances computation.



Other wasting assets

This category covers wasting assets which are not chattels as they are not tangible and/or not movable (for example, immovable plant and machinery, copyrights and licences).

The allowable expenditure on these assets is deemed to waste over the life of the asset on a straight line basis.

Accordingly, when a disposal is made:

- the allowable expenditure is restricted to take account of the asset's natural fall in value
- the asset's fall in value is deemed to occur on a straight line basis over its predictable useful life
- the allowable cost is calculated as:

$$C \text{ less } [P/L \times (C - R)]$$

where:

P = the disposer's period of ownership.

L = the asset's predictable life.

C = the cost of the asset.

R = the residual value of the asset.



Illustration 1 – Wasting assets

On 16 March 2016 Nikolas bought an asset at a cost of £45,000. It had an estimated useful life of 25 years and an estimated scrap value of £6,000. He sold the asset on 17 March 2024.

Calculate the chargeable gain or allowable loss arising from the sale in March 2024 assuming:

- (i) **the asset is a wasting asset and was sold for £34,000**
- (ii) **the asset is plant and machinery eligible for capital allowances and was sold for £34,000**
- (iii) **the asset is plant and machinery eligible for capital allowances and was sold for £63,000.**

Solution

(i) Wasting asset – sold for £34,000	£	£
Sale proceeds		34,000
Less: Cost	45,000	
Less: Wasted cost		
8/25 × (£45,000 – £6,000)	(12,480)	
		<hr/>
Allowable element of acquisition cost		(32,520)
		<hr/>
Chargeable gain		1,480
		<hr/>

(ii) **P&M eligible for capital allowances – sold for £34,000**

Nikolas has sold the machinery for a loss of £11,000 (£45,000 – £34,000).

He is compensated for this loss through the capital allowances system as he receives net capital allowances of £11,000 during his period of ownership of the machinery.

The allowable capital loss computation is therefore adjusted to reflect the relief for the loss already given through the capital allowances system and results in an NGNL situation as follows:

	£	£
Sale proceeds		34,000
Less: Cost	45,000	
Less: Net capital allowances	(11,000)	
		<hr/>
		(34,000)
		<hr/>
Allowable loss		0
		<hr/>

(iii) P&M eligible for capital allowances – sold for £63,000

Normal chargeable gain computation required as any capital allowances given will be claimed back with a balancing charge in the capital allowances system.

	£
Sale proceeds	63,000
Less: Cost	(45,000)
	<hr/>
Chargeable gain	18,000
	<hr/>

**4 Leases**

There are two situations relating to leases that are examinable

- the assignment of a long lease
- the assignment of a short lease.

The assignment of a lease means the complete disposal of the leasehold interest in the property and is usually by way of a sale or a gift.

The calculation of the chargeable gain

The CGT treatment on the assignment of a lease is as follows:

Long lease	Short lease
(i.e. a lease with > 50 years to run at the date of disposal)	(i.e. a lease with 50 years or less to run at the date of disposal)
<ul style="list-style-type: none"> • Normal gain computation applies. 	<ul style="list-style-type: none"> • Disposal of a wasting asset • The allowable expenditure is adjusted to take account of the depreciating nature of the asset • The cost is multiplied by the fraction: $\frac{\% \text{ for life of the lease left on disposal date}}{\% \text{ for life of the lease left on acquisition}}$ • If required, HMRC's lease depreciation percentages will be given in the examination question

Leases depreciate on a curvilinear basis: the lease loses value gradually at first, however at a much quicker rate nearer to the end of the life of the lease.



Test your understanding 4

Frank sold a leasehold shop for £90,000 on 30 September 2023. He had acquired the lease for £50,000 on 1 October 2022 when the lease had 40 years to run.

Lease percentages are as follows:

40 years 95.457%

39 years 94.842%

Compute the chargeable gain arising on the assignment of the short lease in the tax year 2023/24.

The lease percentage calculation

The length of time remaining on a lease at the time of disposal and acquisition is normally straightforward to calculate.

However, there are two situations to look out for:

- Where there are options within the lease to terminate the lease before expiry. The end of the lease is taken to be:
 - the earliest date when either the landlord or the tenant has the option to terminate the lease.
- The length of time remaining on the lease may not always be a whole number of years. Where this is the case:
 - calculations are performed to the nearest month
 - depreciation in between each year is deemed to occur on a straight line basis
 - 1/12th of the difference between the percentages for the years either side of the actual duration is added for each extra month.



Test your understanding 5

Pedro purchased a lease with 48 years to run on 1 September 2018 for £62,000. On 28 January 2024 he sold the lease for £75,000.

Calculate the chargeable gain arising on the sale.

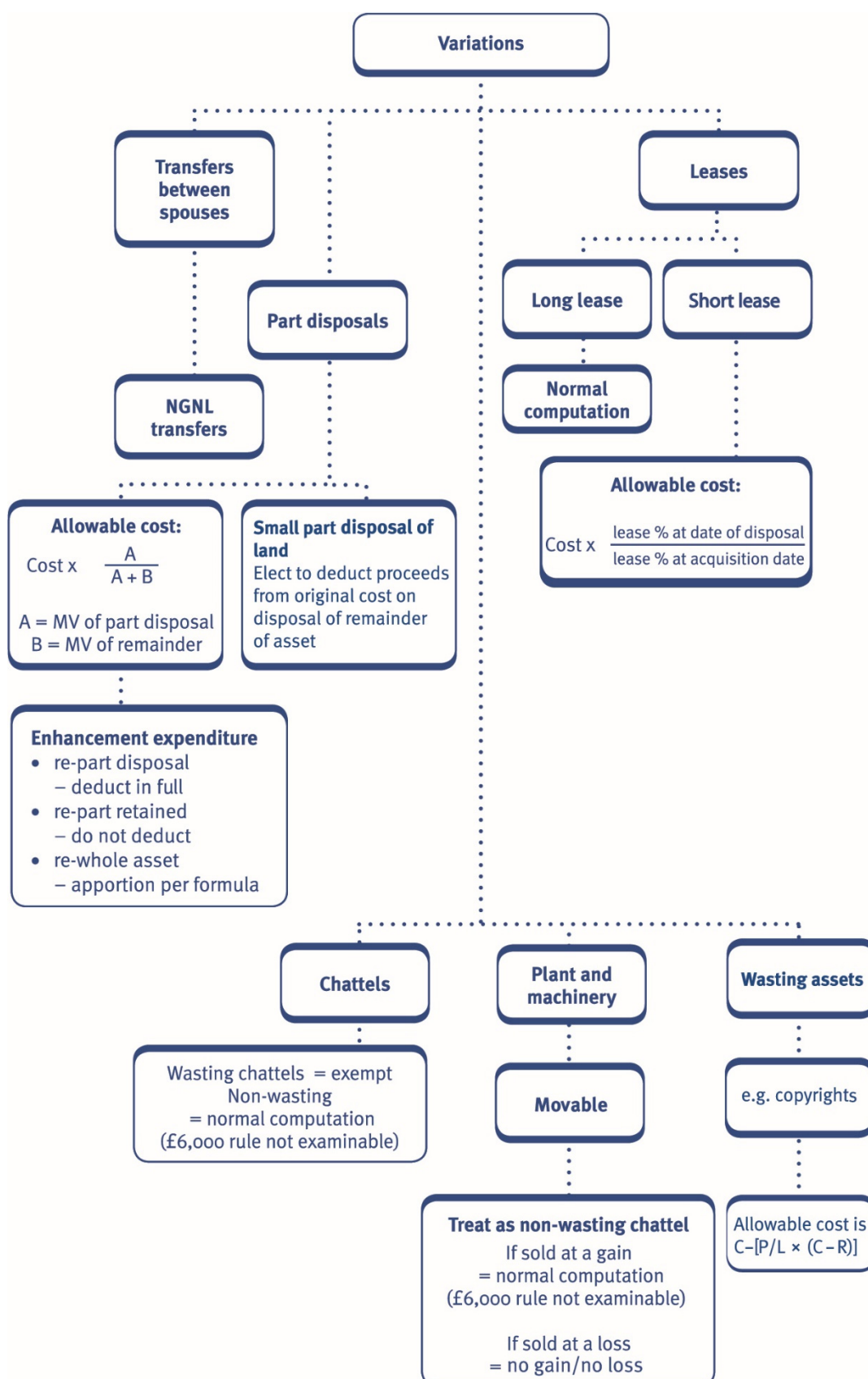
Lease percentages are as follows:

48 years 99.289%

43 years 97.107%

42 years 96.593%

5 Summary of variations to the basic computations



6 Compensation and insurance

Introduction

Most capital transactions have two parties; a buyer and a seller.

However, when an asset is damaged, destroyed or lost and the asset's owner receives compensation (usually from an insurance company):

- the owner has received a capital sum without disposing of the asset
- the payer has received nothing in return.

Consequently a special set of rules is required.

The rules vary according to whether the asset has been:

- completely lost/destroyed or merely damaged
- whether the owner has replaced or restored the asset.



These rules were covered at TX and are summarised in the following sections with diagrams and examples.

Asset is totally destroyed or lost

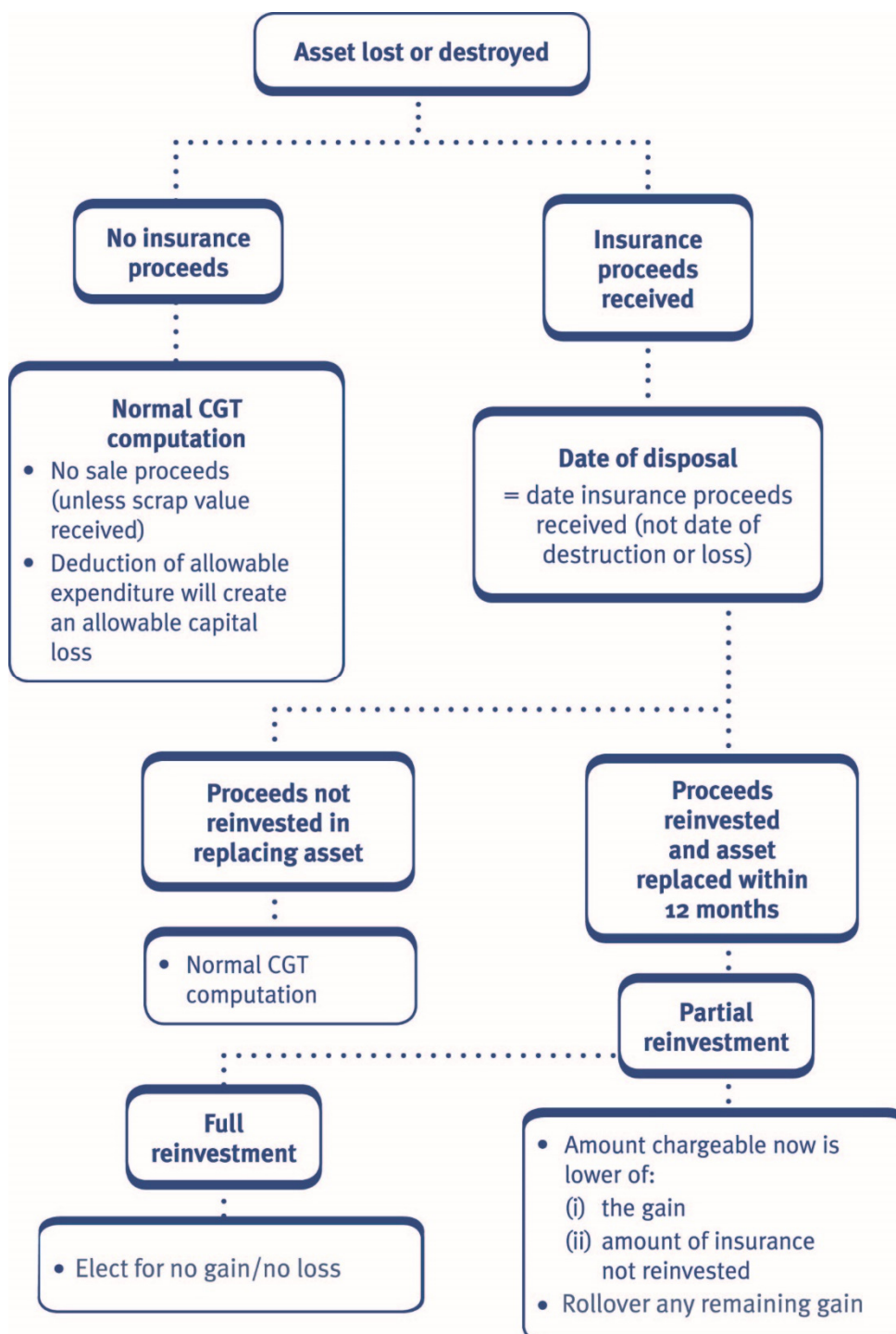




Illustration 2 – Asset destroyed

Nadir purchased a capital asset for £15,000 on 1 April 2003 which was destroyed by fire on 31 July 2023. She received scrap proceeds of £1,000. The asset was not insured.

Calculate the allowable capital loss arising in the tax year 2023/24.

Solution

	£
Proceeds (scrap proceeds)	1,000
Less: Cost	(15,000)
	<hr/>
Allowable loss	(14,000)
	<hr/>



Illustration 3 – Asset destroyed

Bill purchased an asset for £25,000 on 1 October 2004 which was destroyed by fire on 30 September 2023. He received scrap proceeds of £1,000 and compensation of £35,000 from his insurance company on 1 January 2024.

He purchased a replacement asset for £40,000 on 1 February 2024.

Assuming that Bill claims the loss by fire to be a no gain/no loss disposal, calculate the allowable expenditure (base cost) of the replacement asset.

Solution

	£	£
Cost of replacement asset		40,000
Less: Compensation	35,000	
Scrap proceeds	1,000	
	<hr/>	
	36,000	
Less: Cost of old asset	(25,000)	
	<hr/>	
		(11,000)
		<hr/>
Replacement asset base cost		29,000
		<hr/>



Test your understanding 6

Belinda purchased an antique necklace for £21,140 on 1 October 2010 which she lost on 30 June 2023. She received compensation of £45,000 from her insurance company on 1 October 2023 and purchased a replacement necklace for £50,000 on 1 November 2023.

She sold the replacement necklace for £65,000 on 1 March 2024.

Assuming that Belinda claims the loss to be a no gain/no loss disposal, calculate the chargeable gain arising on the sale of the replacement necklace on 1 March 2024.

Asset is damaged but not totally destroyed or lost

Where an asset is damaged there are no implications for CGT purposes unless compensation (e.g. insurance proceeds) is received.

Where an asset is damaged and compensation is received there is a part disposal for CGT purposes. However, the computation is varied depending on whether or not the insurance proceeds are used to restore the asset.

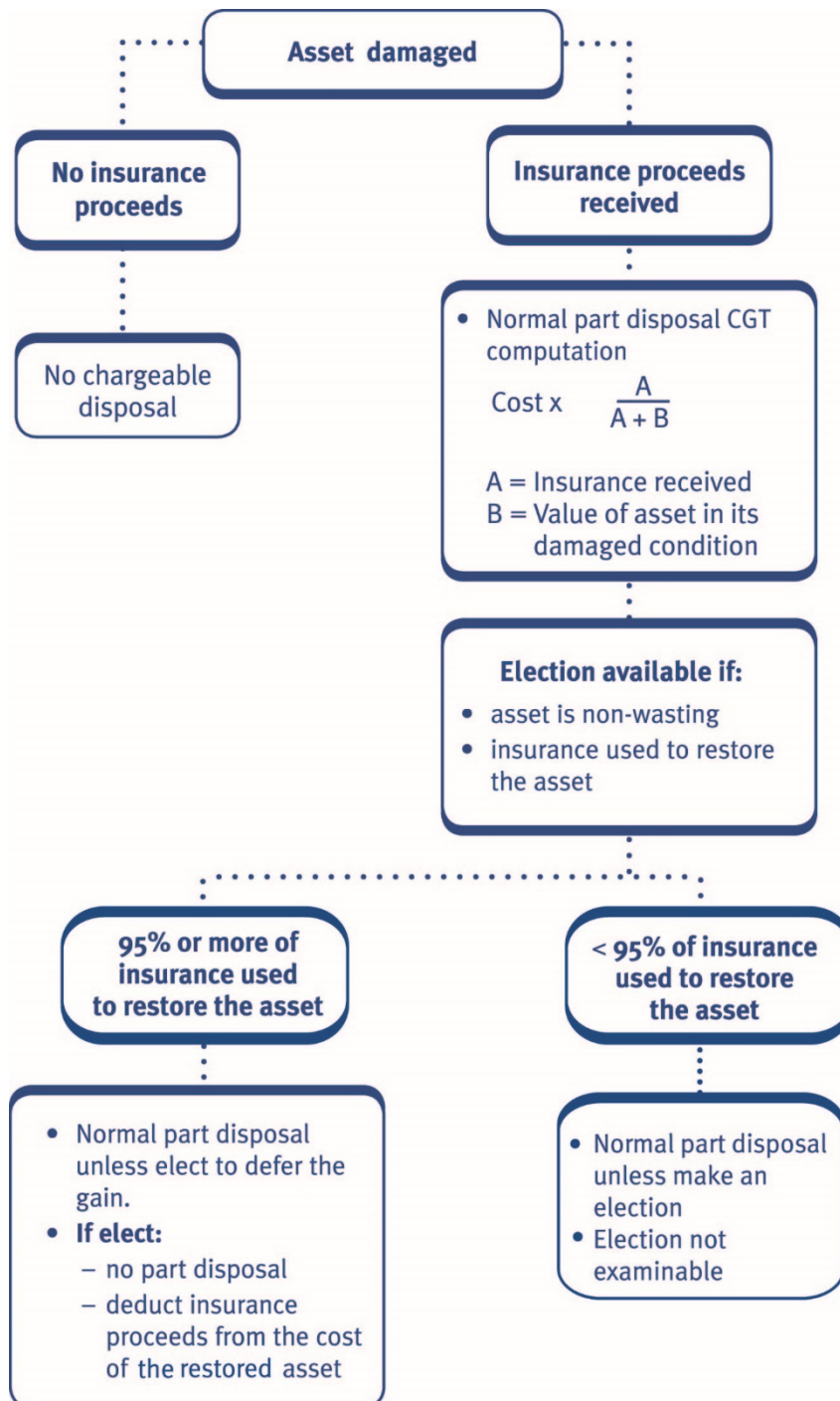



Illustration 4 – Asset damaged, insurance not used to restore asset

Sasha purchased a painting on 1 April 2014 for £10,000. The painting was damaged on 1 May 2023 when it was worth £50,000. After the damage the painting was worth £25,000.

On 1 July 2023 insurance proceeds of £30,000 were received, which were not used to restore the painting.

Calculate the gain, if any, arising in respect of the painting.

Solution

	£
Deemed proceeds	30,000
Less: Cost ($\text{£}10,000 \times \text{£}30,000 / (\text{£}30,000 + \text{£}25,000)$)	(5,455)
	<hr/>
Chargeable gain	24,545
	<hr/>


Illustration 5 – Asset damaged, > 95% of insurance used to restore

Ania purchased a painting on 1 April 2014 for £10,000. The painting was damaged on 1 May 2023 when it was worth £50,000. After the damage the painting was worth £40,000.

On 1 July 2023 insurance proceeds of £8,000 were received. All of the proceeds apart from £300 were used to restore the painting.

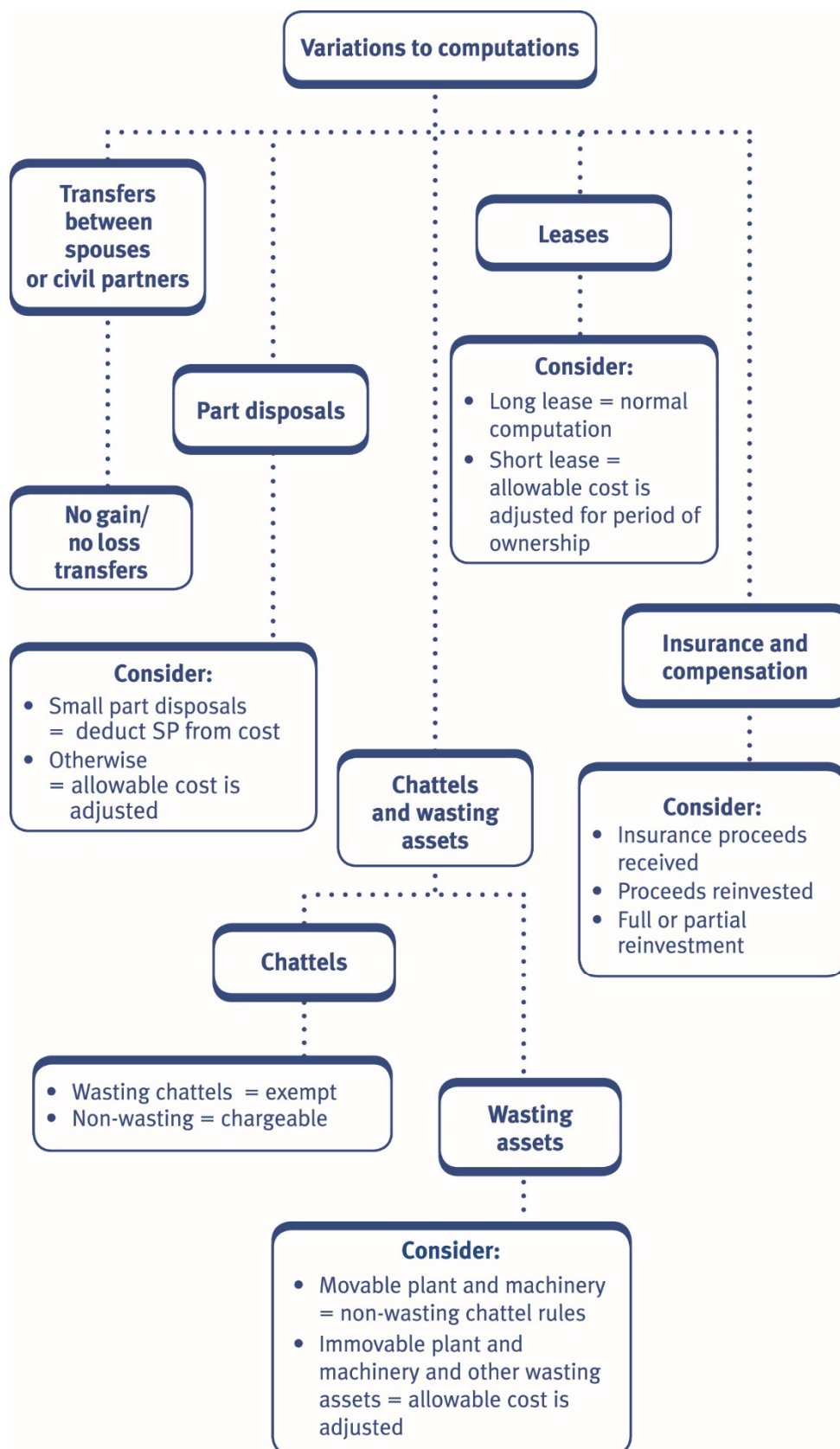
Calculate the revised base cost for CGT purposes of the painting after it has been restored, assuming Ania elects for the insurance proceeds to be rolled over against the cost of the painting.

Solution

As more than 95% of the proceeds are used to restore the asset and Ania has elected for the proceeds to be rolled over against the cost of the painting, there is no part disposal and the revised base cost of the painting is as follows.

	£
Original cost	10,000
Less: Insurance proceeds	(8,000)
	<hr/>
	2,000
Plus: Cost of enhancement ($\text{£}8,000 - \text{£}300$)	7,700
	<hr/>
Revised base cost	9,700
	<hr/>

7 Chapter summary



Test your understanding answers



Test your understanding 1

Motsi**(a) (i) Gift of flat to sister – November 2023**

	£
Market value	175,000
Less: Cost (December 1999)	(23,600)
	<hr/>
Chargeable gain	151,400
	<hr/>

(ii) Gift of flat to civil partner – November 2023

This is a NGNL transfer for Motsi.

(b) Sale of flat by sister – May 2024

	£
Sale proceeds	200,000
Less: Deemed cost	
= market value at the date of the gift	(175,000)
	<hr/>
Chargeable gain	25,000
	<hr/>

(c) Sale of flat by civil partner – May 2024

	£
Sale proceeds	200,000
Less: Deemed cost	(23,600)
	<hr/>
Chargeable gain	176,400
	<hr/>

Note: The rate of CGT applicable to the taxable gain in each of these circumstances would be 18% to the extent that the taxpayer has any basic rate band remaining and 28% on any gain in excess of the remaining basic rate band. This is because the asset being disposed of is residential property which is not fully exempt under PRR.

The tax would be payable within 60 days of completion and a UK land return would need to be submitted at the same time.



Test your understanding 2

Tomasz and Vanessa

Recommendations

Both husband and wife should consider making use of the CGT AEA. This can be achieved if Tomasz transfers part of the ownership of the property to Vanessa prior to the disposal to a third party. The transfer between spouses is treated as a NGNL transaction.

As Vanessa has capital losses brought forward these could be used to offset any gain arising that belongs to her.

Vanessa also has part of her basic rate band remaining, so this should be used. As the asset being disposed of is a residential property and the gain arising will not be fully covered by PRR, gains in the basic rate band will be taxed at 18% whereas Tomasz will be taxed at 28%.

Current position

	Tomasz	Vanessa
	£	£
Chargeable gains	30,000	0
Less: AEA	(6,000)	(not used)
	<hr/>	<hr/>
	24,000	0
Less: Capital loss b/f	(0)	(c/f again)
	<hr/>	<hr/>
Taxable gain	24,000	0
	<hr/>	<hr/>
BRB remaining		
£0/(£37,700 – £16,200)	0	21,500
	<hr/>	<hr/>
CGT payable		
(£24,000 × 28%)/(£0 × 18%)	6,720	0
	<hr/>	<hr/>

Vanessa could receive gains of up to:

- £17,800 (£11,800 capital losses b/f + £6,000 AEA) and have no CGT to pay, and
- a further £21,500 (remaining basic rate band) and only pay CGT at 18%.

The taxation effect

The % which needs to be transferred to obtain the optimum position on disposal is calculated as follows:

Tomasz requires a gain of £6,000 to use his AEA. He will then pay no CGT.

The balance of the gain of £24,000 (£30,000 – £6,000) should be realised by Vanessa to use her AEA of £6,000, capital losses of £11,800 and the remainder is taxed at the basic rate.

A gain of £24,000 for Vanessa out of a total of £30,000 is 80%, therefore 80% ownership of the asset should be transferred to Vanessa pre-sale.

Revised position

	Tomasz	Vanessa
	£	£
Chargeable gains	6,000	24,000
Less: AEA	(6,000)	(6,000)
	<hr/>	<hr/>
	0	18,000
Less: Capital loss b/f	(0)	(11,800)
	<hr/>	<hr/>
Taxable gain	0	6,200
	<hr/>	<hr/>
CGT payable		
(£0 × 28%)/(£6,200 × 18%)	0	1,116
	<hr/>	<hr/>

Tax saving

CGT saving is £5,604 (£6,720 – £1,116).

Alternative calculation:

	£
Utilisation of Vanessa's AEA and capital loss b/f	
Tax saving (£17,800 × 28%)	4,984
Remaining gain taxed at a lower rate	
Tax saving (£6,200 × (28% – 18%))	620
	<hr/>
	5,604
	<hr/>



Test your understanding 3

Edward

(i) **An election to defer the gain on the part disposal is made**

Disposal in July 2023

In July 2023, the whole five hectares are worth £89,500 (£9,500 + £80,000).

This is the only sale of land in the tax year, and the sale proceeds received of £9,500 are

- < £17,900 ($20\% \times £89,500$), and
- < £20,000.

Therefore an election can be made to defer the gain.

No gain arises on the part disposal, the base cost of the remaining four hectares becomes £20,500 (£30,000 – £9,500).

Disposal in September 2024

	£
Sale proceeds	135,000
Less: Base cost	(20,500)
	<hr/>
Chargeable gain	114,500
	<hr/>

(ii) **No election is made**

Disposal in July 2023

	£
Sale proceeds (one hectare)	9,500
Less: Base cost	
Less: Cost (one hectare)	
$= £30,000 \times £9,500 / (£9,500 + £80,000)$	(3,184)
	<hr/>
Chargeable gain	6,316
	<hr/>

Disposal in September 2024

	£
Sale proceeds	135,000
Less: Remaining cost (£30,000 – £3,184)	(26,816)
	<hr/>
Chargeable gain	108,184
	<hr/>

Note: The total chargeable gains = £114,500 (£6,316 + £108,184) which is the same total as part (i).

However, with the election the gain is deferred until the later disposal of the remainder. Whether or not this is beneficial will depend on the availability of AEAs, the level of taxable income and the tax rates applicable when the disposals are made.



Test your understanding 4

Frank

	£
Sale proceeds	90,000
Less: Deemed cost	
94.842 (% for 39 years)	
£50,000 × $\frac{\quad}{95.457 \text{ (% for 40 years)}}$	(49,678)
Chargeable gain	<u>40,322</u>



Test your understanding 5

Pedro

	£
Disposal proceeds	75,000
Less: Deemed cost (W)	<u>(60,504)</u>
Chargeable gain	<u>14,496</u>

Working: Deductible lease cost

Years left to run at acquisition: 48 years

Years left to run at disposal: 42 years 7 months

The percentage for 42 years 7 months is:

$$96.593 + 7/12 \times (97.107 - 96.593) = 96.893$$

The allowable cost to deduct in the computation is therefore:

$$\begin{array}{rcl} & 96.893 \text{ (% for 42 years 7 months)} & \\ \text{£62,000} \times & \frac{\quad}{99.289 \text{ (% for 48 years)}} & \\ = & \text{£60,504} & \end{array}$$



Test your understanding 6

Belinda

	£
Proceeds	65,000
Less: Cost (W)	(26,140)
	<hr/>
Chargeable gain	38,860
	<hr/>

Working: Replacement asset base cost

	£	£
Cost of replacement necklace		50,000
Insurance proceeds	45,000	
Less: Base cost	(21,140)	
	<hr/>	(23,860)
		<hr/>
Replacement asset base cost		26,140
		<hr/>

CGT: Shares and securities for individuals and stamp duty

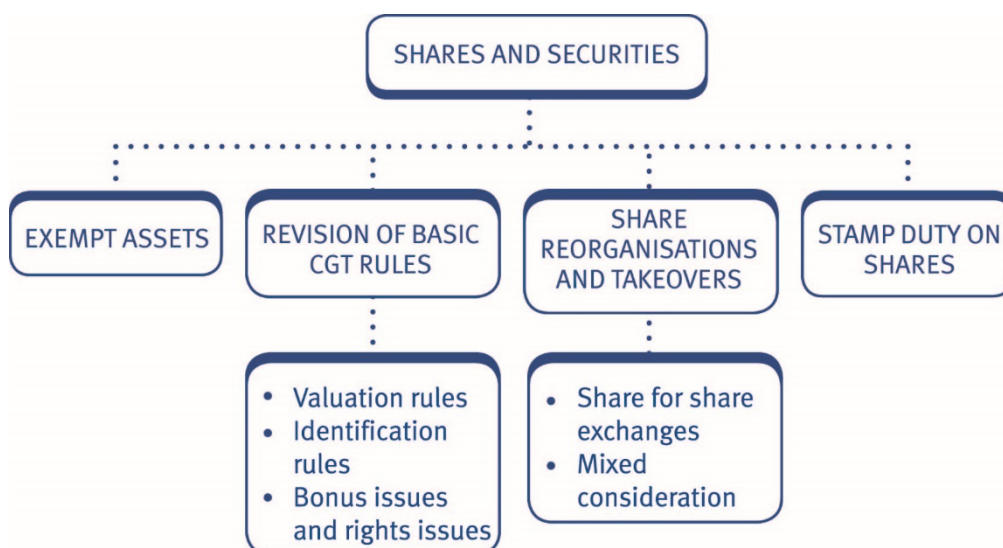
Chapter learning objectives

Upon completion of this chapter you will be able to:

- calculate the gain on the disposal of shares by an individual including situations which involve bonus and rights issues
- extend the explanation of the treatment of rights issues to include the small part disposal rules applicable to rights issues
- define a qualifying corporate bond (QCB), and understand what makes a corporate bond non-qualifying. Understand the capital gains tax implications of the disposal of QCBs in exchange for cash or shares
- apply the rules relating to reorganisations, reconstructions and amalgamations and advise on the most tax efficient options available in given circumstances
- establish the relief for capital losses on shares in unquoted trading companies
- identify the property in respect of which stamp taxes are payable
- advise on the stamp taxes payable on transfers of shares and securities
- advise on the use of exemptions and reliefs in deferring and minimising stamp taxes: identify transfers involving no consideration.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. Working through this chapter should help you understand how to demonstrate that objective.



Introduction



This chapter revises the CGT rules as they apply to shares and securities, which were covered at TX.

A brief reminder of TX content is given, and revision examples are provided to check your retention of the required TX knowledge.

New topics introduced at ATX include the treatment of the sale of rights nil paid, share reorganisations with mixed consideration, the liquidation of a company and stamp duty which is levied on transactions in shares.

1 A revision of basic shares and securities rules

Exempt shares and securities

All shares and securities disposed of by an individual are subject to CGT except for the following, which are exempt:

- listed government securities (i.e. gilt-edged securities) (e.g. Treasury stock, Exchequer stock)
- qualifying corporate bonds (QCB) (e.g. company loan stock)
- shares held in an ISA.

Note that gilt-edged securities and QCBs are exempt assets only when disposed of by an individual or a trust (but not when disposed of by a company, see Chapter 2).

**Definition of a QCB**

A QCB is a security (loan note) which:

- (a) represents a normal commercial loan
- (b) is expressed in sterling and has no provision for either conversion into, or redemption in, any other currency, and
- (c) was issued after 13 March 1984 or was acquired by the disposer after that date (whenever it was issued), and
- (d) cannot be converted into shares.

Valuation rules for shares

For the purposes of the rest of this chapter, the rules described apply to both shares and securities which are not exempt. However, for simplicity the term 'shares' will be used to denote both shares and securities.

On the sale of shares to an unconnected person, the actual sale proceeds are used in the chargeable gain computation.

On a lifetime gift of shares, or the transfer to a connected person, the market value must be used.

The market value of shares for lifetime gifts, for CGT purposes, is calculated as follows:

Quoted shares	Value = the mid-price quoted on the Stock Exchange (i.e. the simple average of the lowest and highest closing prices of the day).
Unquoted shares	In the examination the appropriate value will usually be given.

**Test your understanding 1**

The closing prices of shares in ABC plc are quoted in the Stock Exchange Daily Official List at 230p – 270p.

Calculate the value of ABC plc shares for capital gains tax purposes.

For the valuation rules for shares gifted on death, see Chapter 6.

Identification rules for individuals

Disposals of shares are matched in the following order with acquisitions:

- (1) on the same day as the date of disposal
- (2) within the **following** 30 days on a first in, first out (FIFO) basis
- (3) in the share pool
(i.e. shares acquired before the date of disposal are pooled together).

The share pool simply keeps a record of the number of shares in the same company acquired and sold, and the cost of those shares.

When shares are disposed out of the share pool the appropriate proportion of the cost that relates to the shares disposed of is calculated. The shares are disposed of at their average cost.

Bonus issues and rights issues

	Bonus issue	Rights issue
Explanation	<p>A bonus issue is:</p> <ul style="list-style-type: none"> the distribution of free shares to existing shareholders only in proportion to their existing shareholding. 	<p>A rights issue is:</p> <ul style="list-style-type: none"> the offer of new shares to existing shareholders only in proportion to their existing shareholding usually at a discount on the current market value.
For identification purposes	Bonus and rights shares are included in the share pool.	
For the purposes of calculating the gain on the shares	<p>As bonus shares are free:</p> <ul style="list-style-type: none"> the number of shares are included in the pool, but no cost the total cost of the shares purchased is shared between all of the shares in issue after the bonus issue. 	<p>As there is cost involved in purchasing the rights shares:</p> <ul style="list-style-type: none"> the number of shares are included in the pool, and the cost is added in the same way as a normal purchase the total cost is shared between all of the shares in issue after the rights issue.



Illustration 1 – Bonus and rights issues

Carmichael had the following transactions in Rudderham Ltd shares.

January 2020 purchased 1,800 shares for £5,400

March 2021 bonus issue of 1 for 2

May 2021 purchased 600 shares for £1,500

June 2021 took up 1-for-3 rights issue at £2.30 per share

August 2023 sold 4,000 shares for £14,000

Calculate the chargeable gain or allowable loss on the disposal in August 2023.

Solution

		Number	Cost £
January 2020	Purchase	1,800	5,400
March 2021	Bonus issue (1:2)	900	0
May 2021	Purchase	600	1,500
		<hr/>	<hr/>
		3,300	6,900
June 2021	Rights issue (1:3) × £2.30	1,100	2,530
		<hr/>	<hr/>
		4,400	9,430
August 2023	Sale	(4,000)	(8,573)
		<hr/>	<hr/>
Balance c/f		400	857
		<hr/>	<hr/>
			£
	Sale proceeds		14,000
	Less: Cost		(8,573)
			<hr/>
	Chargeable gain		5,427
			<hr/>



Test your understanding 2

Manaia purchased the following shares in A plc:

	Number	Cost £
18 April 2000	1,500	900
14 June 2003 Rights issue (70p each)	1:3	
31 May 2012	1,000	2,000
31 July 2012 Bonus issue	1:4	
31 August 2016	900	1,500
28 January 2024	1,500	3,000

Manaia disposed of 4,500 shares in A plc on 31 December 2023 for £22,500.

Identify which shares are sold and calculate the total taxable gains arising in the tax year 2023/24.



Sale of rights nil paid

If the shareholder who is offered the rights issue does not wish to purchase more shares in the company, the shareholder can sell the right to buy the new shares to another person. This is known as a 'sale of rights nil paid'.

The treatment of a 'sale of rights nil paid' for CGT purposes depends on the amount of sale proceeds (SP) received as follows:

If SP received are:	(i) > 5% of the value of the shares on which the rights are offered, and (ii) > £3,000.	(i) ≤ 5% of the value of the shares on which the rights are offered, or (ii) ≤ £3,000 if higher.
CGT treatment:	<ul style="list-style-type: none"> Deemed part disposal of original shares held. Normal part disposal computation required. 	<ul style="list-style-type: none"> No chargeable disposal at the time of the sale of rights nil paid. SP received are deducted from the cost of the original shares. Taxpayer can elect for a part disposal if preferred, e.g. to use AEA.



Test your understanding 3

Mustafa acquired 12,000 shares in Pickford plc on 22 July 2002 for £24,000.

On 13 August 2023 there was a 1 for 5 rights issue at £2.30 per share. The market value of the shares after the issue was £2.65 per share.

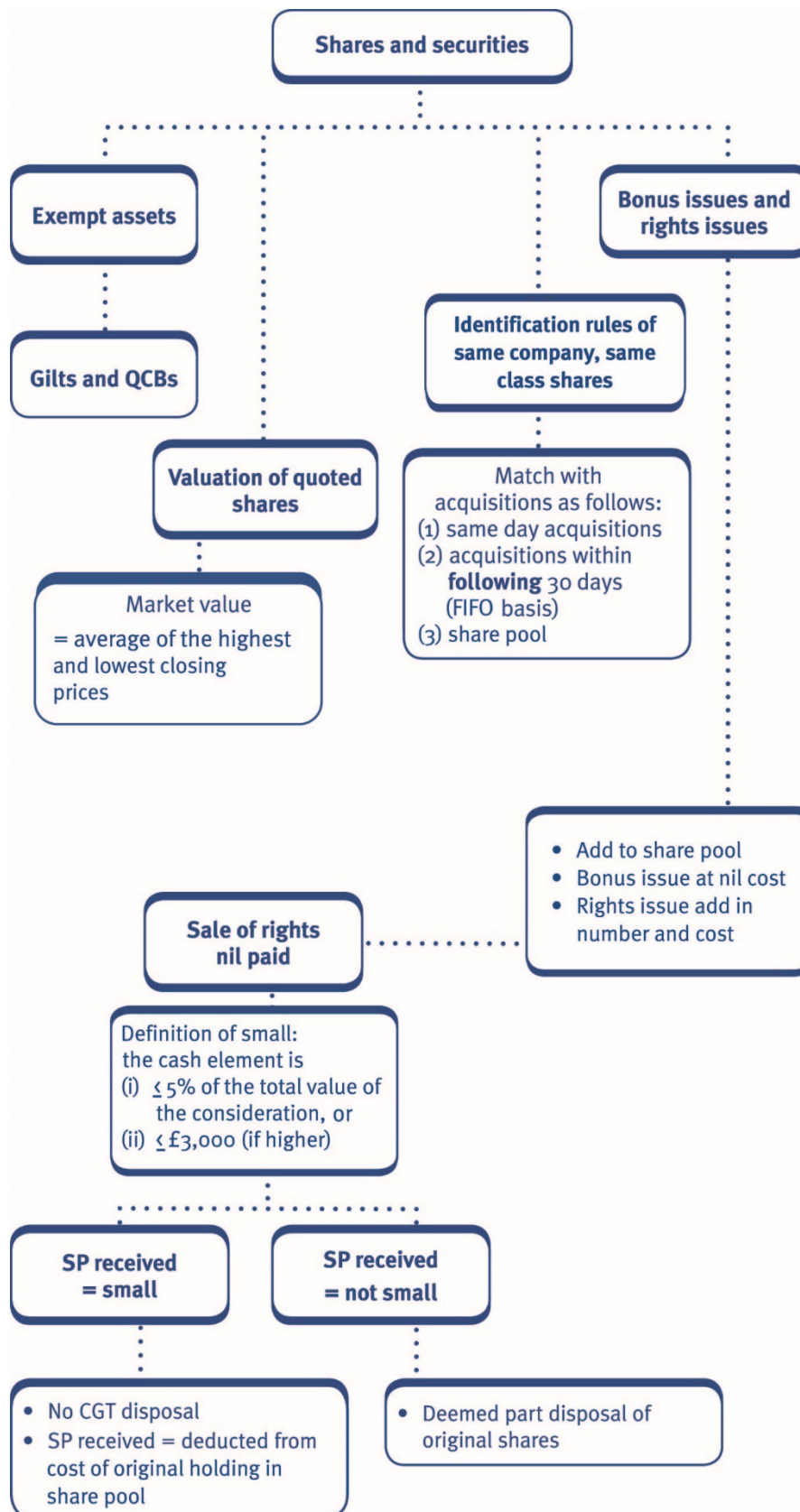
Mustafa did not take up the issue, but sold his rights nil paid on 25 August 2023.

He sold 10,000 of his shares in Pickford plc for £37,000 on 23 June 2024.

Calculate the chargeable gains arising assuming the rights are sold nil paid for:

- (a) **£6,000**
- (b) **£1,500.**

Summary



2 Reorganisations and takeovers

Introduction



A reorganisation involves the exchange of existing shares in a company for other shares of another class in the same company.



A takeover occurs when a company acquires shares in another by issuing:

- shares
- loan notes
- cash.

Share for share exchanges

Where the consideration for a reorganisation or takeover only involves the issue of shares in the acquiring company, the transaction is referred to as a 'paper for paper' transaction.



A reminder of the share for share exchange rules covered at TX is given in supplementary reading below and is summarised in the diagram at the end of this section.



Share for share exchange

The tax consequences are as follows:

- No CGT is charged at the time of the reorganisation/takeover.
 - The new shares acquired are treated as if they were acquired at the same time and at the same cost as the original shares.
 - The new shares 'stand in the shoes' of the old shares (i.e. the date of purchase and the cost of the original shares become the deemed date of purchase and cost of the new shares acquired).
- Where the shareholder receives more than one type of share in exchange for the original shares, the cost of the original shares is apportioned to the new shares by reference to the market values of the replacement shares and securities as follows:
 - quoted shares: **on the first day of quotation**
 - unquoted shares: **at the time of the first disposal** of those shares.

For this treatment to apply where Company A is taking over Company B, the following qualifying conditions must be satisfied:

- Company A obtains more than 25% of Company B's ordinary share capital as a result of the offer, or
- there is a general offer to members of Company B which would give control to Company A if accepted, or
- Company A can exercise more than 50% of the voting power in Company B
- The exchange is for a bona fide commercial reason
- The exchange is not part of a scheme or arrangement which has as its main purpose the avoidance of CGT or corporation tax.

The acquiring company can obtain advance clearance from HMRC that the transaction comes within these rules and that the qualifying conditions have been met.



Test your understanding 4

Milena purchased 2,000 ordinary shares in Blue plc for £5,000 in June 2019.

In July 2023 Blue plc underwent a reorganisation and Milena received two 'A' ordinary shares and one preference share for each ordinary share. Immediately after the reorganisation 'A' ordinary shares were quoted at £2 and preference shares at £1.

In December 2023 Milena sold all her holding of 'A' ordinary shares for £8,000.

Calculate the chargeable gain or allowable loss arising on the disposal in December 2023.

The individual taxpayer may choose to disapply the normal share for share rules if this would be beneficial.



Interaction with business asset disposal relief

- Business asset disposal relief (BADR) will only be available on a future disposal of the replacement shares if the replacement shares meet the necessary conditions (see Chapter 9).
- It therefore may be more beneficial to choose to disapply the normal share for share exchange rules, so that any gain on disposal of ordinary shares is chargeable to CGT immediately and may be covered by the AEA and/or the gain arising is taxed at 10% to take advantage of BADR available now.



Takeovers: Consideration in cash and shares

If the consideration for the takeover consists of a mixture of cash and shares, the tax consequences depend on whether the cash element of the transaction is small.

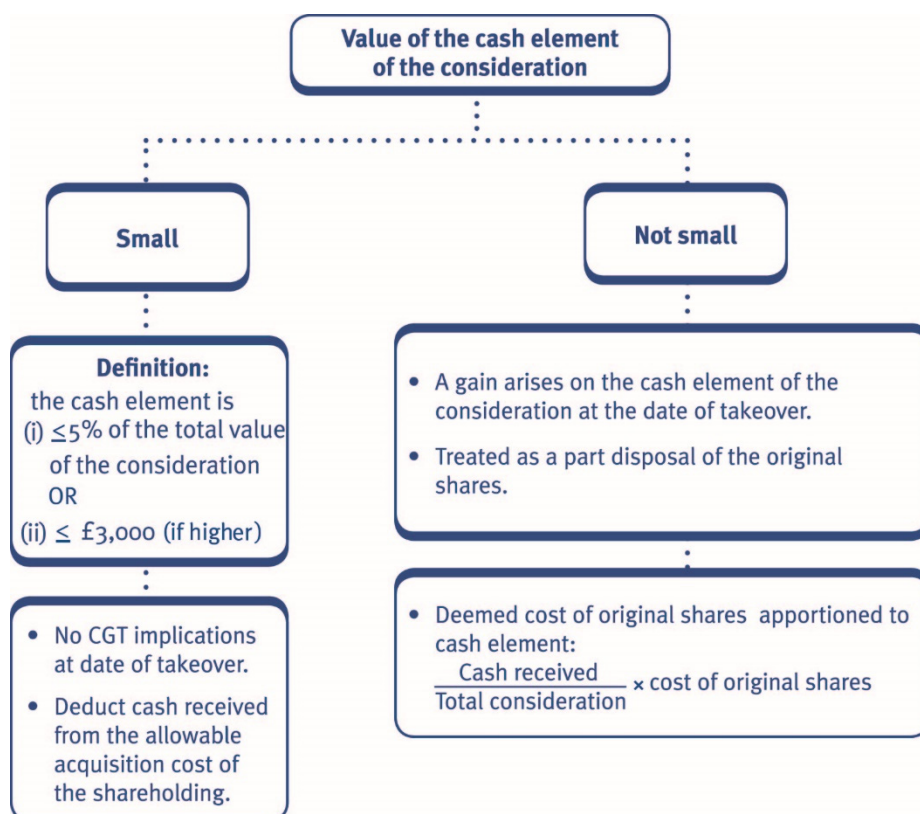


Illustration 2 – Takeovers

Patrick bought 10,000 shares in Target plc in May 2017 for £20,000.

On 3 November 2023 the entire share capital of Target plc was acquired by Bidder plc. Target plc shareholders received 2 Bidder plc shares and £0.50 cash for each share held. Bidder plc shares were quoted at £1.25.

Calculate the chargeable gain accruing to Patrick as a result of the takeover in November 2023.

Solution

	£
Shares (20,000 × £1.25)	25,000
Cash (10,000 × £0.50)	5,000
	<hr/>
Total consideration from Bidder plc	30,000
	<hr/>

The cash Patrick has received of £5,000 exceeds higher of:

- £3,000, and
- 5% of the total value of the consideration ($5\% \times £30,000 = £1,500$).

Therefore, the value of the cash element is not small and there is a deemed part disposal of the original Target plc shares as follows:

	£
Disposal proceeds (cash)	5,000
Less: Deemed cost of Target plc shares relating to the cash consideration received $((5,000/30,000) \times £20,000)$	 (3,333)
	<hr/>
Chargeable gain	1,667
	<hr/>

Patrick's allowable cost on the future disposal of his shares in Bidder plc will be £16,667 (£20,000 – £3,333).



Test your understanding 5

Victoria held 10,000 shares in Forum Follies Ltd, an unquoted trading company, which she purchased in May 2012 for £15,000.

In January 2024 Exciting Enterprises plc acquired all the share capital of Forum Follies Ltd.

Under the terms of the takeover, shareholders in Forum Follies Ltd received three ordinary shares and one preference share in Exciting Enterprises plc, plus £1 cash for every one share previously held in Forum Follies Ltd.

Immediately after the takeover, the shares in Exciting Enterprises plc are quoted at £3 each (ordinary shares) and £1.50 each (preference shares).

Victoria has never worked for Forum Follies Ltd and has taxable income of £60,000 for the tax year 2023/24.

Calculate Victoria's capital gains tax liability for the tax year 2023/24.



Takeovers: Mixed consideration, including QCBs

If consideration for the takeover consists of a mixture of shares, cash and QCBs (e.g. company loan notes), there are CGT consequences relating to:

- the cash element of the consideration
- the QCBs received.

At the time of the takeover

The tax consequences relating to the cash element of the consideration are the same as summarised in the previous section above.

The tax consequences of receiving QCBs in exchange for shares as part of the takeover consideration are as follows:

- a chargeable gain is computed at the time of the takeover, as if the corporate bond were cash
- the gain is not taxed at that time
- the gain is 'frozen' and is not charged until the corporate bond is disposed of at a later date.

Subsequent disposal of corporate bond

When the corporate bond is disposed of:

- no gain arises on the bond itself as QCBs are exempt assets
- the 'frozen' gain becomes chargeable and will be taxed at 10%/20%.

Interaction with business asset disposal relief

- If BADR is available on the gain computed at the time of the takeover, the taxpayer may elect for BADR (see Chapter 9), and the gain eligible will be taxed at 10% at that time.
- If BADR is not claimed, the gain at takeover will be deferred, as described above, and will be taxed at the appropriate rate when the QCB is disposed of in the future.

Tax planning

These rules provide a tax planning opportunity as the individual:

- can choose when to dispose of the QCBs
- can dispose of the QCBs in small amounts on a piecemeal basis.

The individual can plan to ensure that, as far as possible, the deferred gain is crystallised and matched against:

- any unused annual exempt amount each year
- any available capital losses

so that no CGT arises on the disposal of the QCBs.



Illustration 3 – Mixed consideration

On 26 May 2023, Klea sold 200 £1 ordinary shares in Café plc for £5,500 and all of her loan notes in Café plc for £9,600.

Klea originally bought 1,500 shares in Joe's Café Ltd in July 2017 for their market value of £1,215 when she started to work for the business.

Joe's Café Ltd was taken over by Café plc in August 2018.

For every 20 ordinary shares held in Joe's Café Ltd a shareholder received:

- £100 in cash
- 10 ordinary shares in Café plc
- £1 loan notes in Café plc.

Immediately after the takeover the value of Café plc's shares and securities were:

£1 ordinary shares	£12
Loan notes	£55

Calculate the chargeable gains arising in the tax years 2018/19 and 2023/24.

Solution

Apportionment of cost of Joe's Café Ltd 1,500 ordinary shares to the consideration received in August 2018.

	Purchase consideration	Cost allocation
	£	£
Cash		
(£100 × 1,500/20)	7,500	
(£1,215 × £7,500/£20,625)		442
750 ordinary shares in Café plc		
(10 × £12 × 1,500/20)	9,000	
(£1,215 × £9,000/£20,625)		530
Loan notes		
(£55 × 1,500/20)	4,125	
(£1,215 × £4,125/£20,625)		243
	<hr/>	<hr/>
	20,625	1,215
	<hr/>	<hr/>

Cash consideration of £7,500 exceeds £3,000 and exceeds £1,031 (5% of £20,625).

Therefore cash consideration is not small. A part disposal would have arisen in 2018/19 on the cash consideration as follows:

Disposal of Joe's Café Ltd shares for cash – August 2018

	£
Cash received	7,500
Less: Deemed cost	(442)
	<hr/>
Chargeable gain in 2018/19	7,058
	<hr/>

Disposal of Joe's Café Ltd shares for QCBs (loan notes) – August 2018

	£
Value of loan notes received	4,125
Less: Deemed cost	(243)
	<hr/>
'Frozen' gain	3,882
	<hr/>
Taxable at time of takeover in 2018/19	0
	<hr/>
Total chargeable gains in 2018/19 (£7,058 + 0)	7,058
	<hr/>

Disposal of 200 Café plc shares – 26 May 2023

	£
Proceeds	5,500
Less: Deemed cost (£530 × 200/750)	(141)
	<hr/>
Chargeable gain	5,359
	<hr/>

Disposal of Café plc loan notes – 26 May 2023

The gain on the disposal of the loan notes of £5,475 (£9,600 – £4,125) is exempt from CGT, as the loan notes are QCBs.

However, the frozen gain that arose at the time of the takeover in 2018/19 becomes chargeable in 2023/24 on the disposal of the loan notes.

	£
Chargeable gain in 2023/24 when the loan notes are sold	3,882
	<hr/>
Total chargeable gains in 2023/24 (£5,359 + £3,882)	9,241
	<hr/>



Test your understanding 6

On 31 March 2024, Jasper sold 400 £1 ordinary shares in Grasp plc for £3,600.

Jasper had acquired the Grasp plc shares as a result of a successful takeover bid by Grasp plc of Cawte plc on 5 December 2023.

Prior to the takeover Jasper had owned 12,000 £1 ordinary shares in Cawte plc, which he had acquired for £15,700 on 3 May 2020.

The terms of the take-over bid were:

- one £1 ordinary share in Grasp plc, plus
- two 10% £1 loan notes in Grasp plc, plus
- 40p in cash

for every £1 ordinary share in Cawte plc.

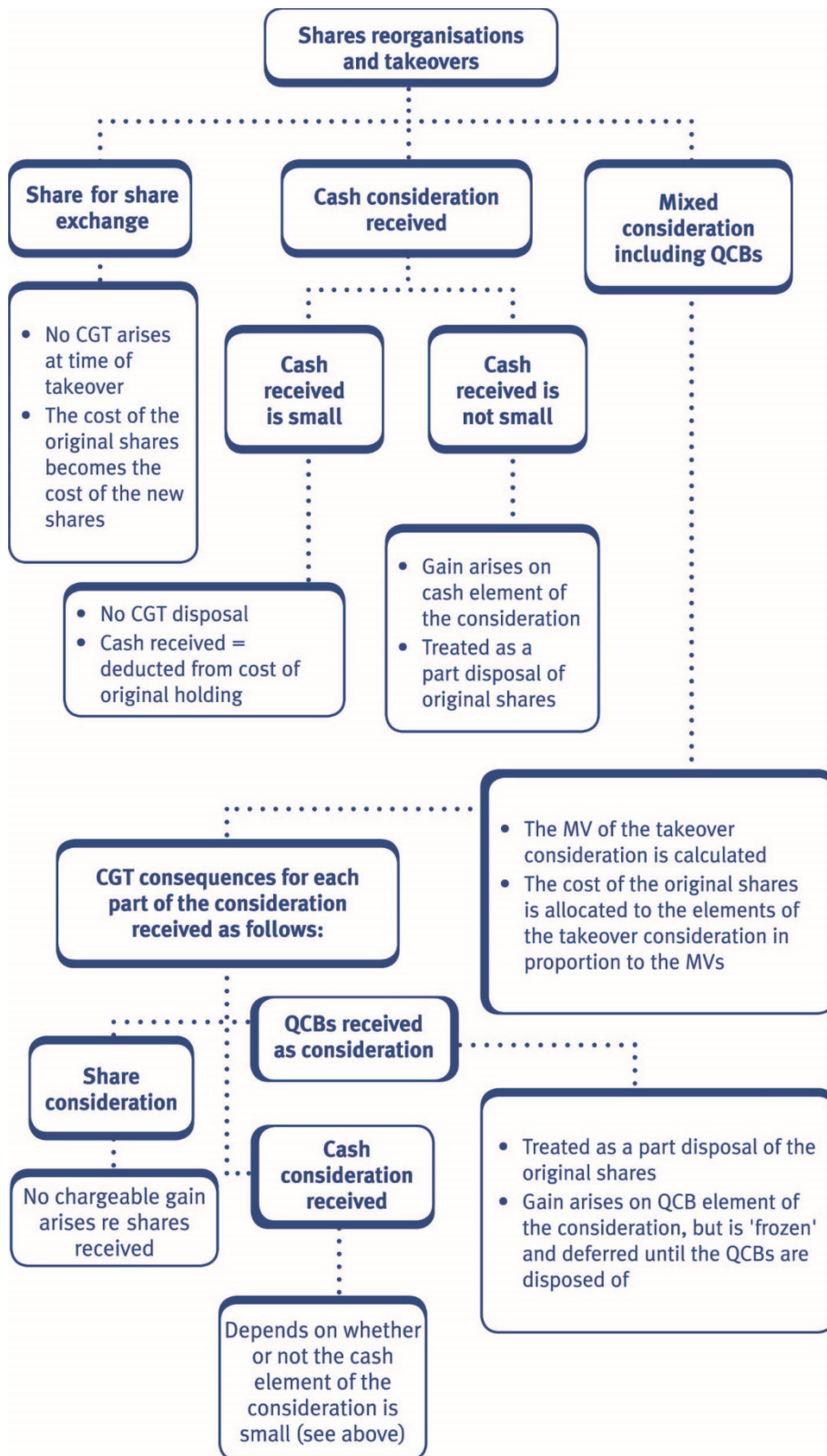
The following are the quoted prices for the shares and loan notes of Grasp plc at 5 December 2023:

£1 ordinary shares	350p
--------------------	------

10% £1 loan notes	110p
-------------------	------

- (a) **Calculate the chargeable gains arising in the tax year 2023/24.**
- (b) **Explain the CGT consequences that would arise if Jasper were to sell all of his loan notes in Grasp plc in June 2025 for £32,000.**

Summary





3 The liquidation of a company

On the liquidation of a company, the liquidator will distribute cash or other assets to the shareholders once the company's liabilities have been paid.

The CGT implications are as follows:

- the shareholders are treated as having sold their shares for proceeds equal to the amount received on the liquidation
- a chargeable gain on the disposal of shares must be computed in the normal way.

Loss relief against income

Capital losses are normally carried forward and used to reduce future chargeable gains. However, an alternative use of the capital loss can be claimed.

Relief against income is available if:

- the loss arises on **shares subscribed** for in an **unquoted trading company**, and
- conditions are satisfied.

A claim for relief against income enables the individual:

- to use the capital loss to reduce total income
- of the tax year in which the loss arose and/or the preceding tax year.

Therefore, the claim effectively converts a capital loss into a trading loss which can be utilised in the same way as trading loss relief against total income (see Chapter 21).

As a result, it is possible that higher tax savings can be achieved and relief for the losses obtained earlier.



Conditions for loss relief against income

Relief against income is only available if:

- the loss arose on the disposal of:
 - unquoted ordinary shares
 - in an eligible trading company (an Enterprise Investment Scheme (EIS) company will qualify).
- the shares must have been subscribed for, not purchased, and
- the disposal must have:
 - been an arm's length transaction for full consideration, or
 - occurred on the winding-up of the company, or
 - been because the value of the shares has become negligible.



Test your understanding 7

Artem subscribed for 5,000 shares in Waltz Ltd, an unquoted trading company, in August 2015 for £3 per share.

On 1 December 2023, Artem received a letter informing him that the company had gone into receivership. As a result, the shares are almost worthless.

The receivers dealing with the company estimate that on the liquidation, he will receive 10p per share.

Artem has non-savings income of £45,000 in the tax year 2023/24.

State any reliefs Artem can claim regarding the fall in value of his shares in Waltz Ltd and describe the operation of any reliefs which could reduce Artem's taxable income.



4 Stamp duty and stamp duty reserve tax

Introduction

Stamp duty land tax is covered in detail in Chapter 6. This section covers stamp duty, which is payable on the transfer of shares and other marketable securities unless the transfer is specifically exempt.

Stamp duty is payable:

- normally by the purchaser
- on the transfer of shares and securities when transferred by a formal instrument (e.g. a written document known as a stock transfer form)
- not on newly issued shares
- based on the consideration payable for the shares/securities (note that this is not necessarily the market value of the shares).

Where shares and securities are transferred without a written document, for example where shares are transferred electronically, stamp duty reserve tax (SDRT) applies.

The rate of duty payable

Stamp duty is normally:

- charged at a rate of 0.5% of the consideration payable for the shares/securities
- rounded up to the nearest £5
- levied on the date of the transfer document
- there is no charge if the consideration is £1,000 or less.

SDRT is normally

- charged at a rate of 0.5% of the consideration payable for the shares/securities
- rounded to the nearest pence
- levied on the date of the agreement.



Exemptions from stamp duty

The main exemptions from stamp duty relate to either the type of transfer or the type of security being transferred as follows:

- exempt transfers:
 - gifts, provided no consideration is given
 - divorce arrangements
 - variation of a will
 - change in composition of trustees
 - takeovers and reconstructions where the new shareholdings mirror the old shareholdings
 - transfers between 75% group companies (see Chapter 4)
 - investment transfers.
- exempt securities:
 - government stocks
 - most company loan stock (but not convertible loan stock)
 - unit trusts
 - shares quoted on growth markets (e.g. AIM shares).

To qualify for exemption, the transfer document must state which exemption is being claimed.



Company loan stock exempt from stamp duty

Most company loan stock is exempt from stamp duty provided it:

- (a) cannot be converted into shares or other securities, and
- (b) does not carry interest at more than a commercial rate or at a rate linked to the company results, and
- (c) does not carry the right to the repayment of more than the nominal amount of the capital, unless the premium is reasonable in relation to other loan stock listed in the Stock Exchange Daily Official List.



Illustration 4 – Stamp duty

Harry made the following purchases in the tax year 2023/24:

- (a) 5,000 shares in a quoted company for £10,000
- (b) £8,000 8% convertible loan stock of a quoted company for £12,000
- (c) £10,000 5% Treasury Stock 2025 for £9,000
- (d) 5,000 units in Growbig unit trust for £6,250
- (e) 10,000 £1 ordinary shares in an unquoted company for £75,000. The shares had a market value of £250,000 at that time.

Show how much stamp duty is payable by Harry on each of these transactions.

Solution

- (a) $0.5\% \times £10,000 = £50$
- (b) $0.5\% \times £12,000 = £60$
- (c) Nil – there is no stamp duty on the purchase of government securities
- (d) Nil – there is no stamp duty on the purchase of units in a unit trust
- (e) $0.5\% \times £75,000 = £375$ (the market value of the shares is not relevant).



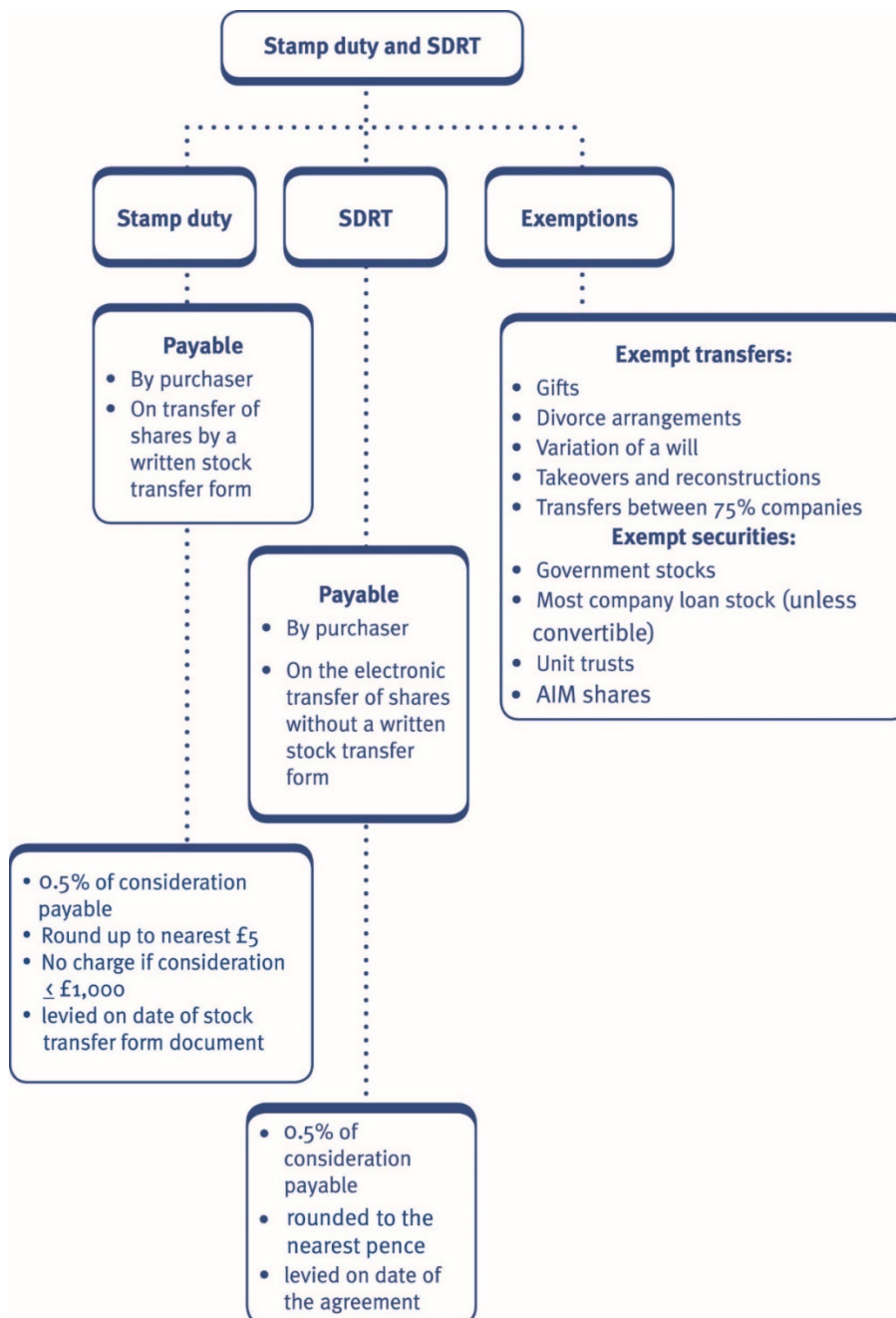
Test your understanding 8

In February 2024, Katya purchased the following:

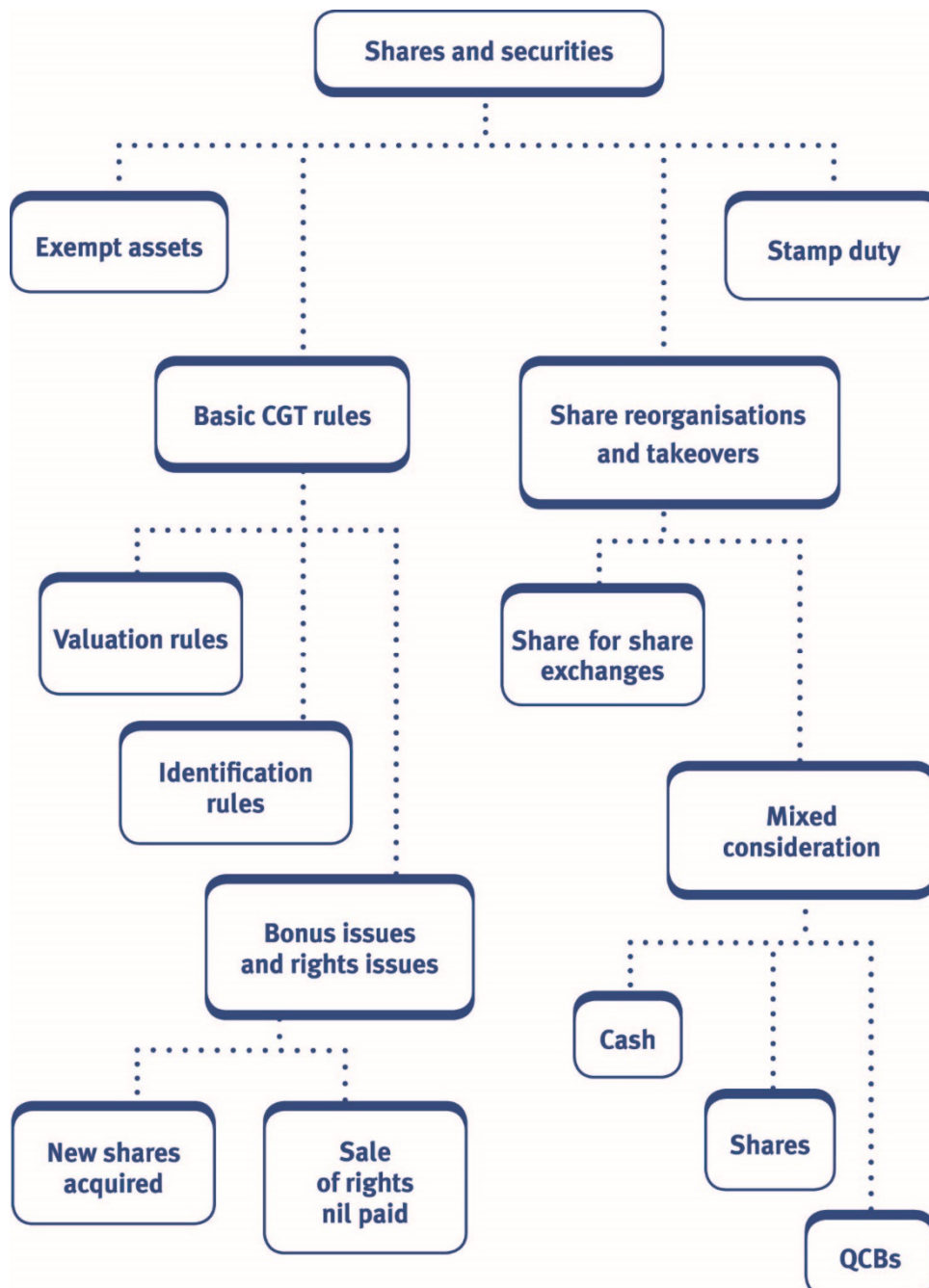
- (a) 5,000 shares in Summit Ltd for £10,230
- (b) the whole of the issued share capital of Harcourts Ltd for £125,000 plus an additional payment of £35,000 if the company's profits for the year ending 31 December 2023 exceed £80,000
- (c) £10,000 5% Treasury Stock 2026 for £9,500.

Calculate the amount of stamp duty payable.

Summary



5 Chapter summary



Test your understanding answers



Test your understanding 1

ABC plc

Value = Average of the highest and lowest closing prices
 $= (270p + 230p) \times \frac{1}{2} = 250p$



Test your understanding 2

Manaia

Shares sold matched with:

	Number
(a) Shares acquired on the same day	0
(b) Shares acquired in the next 30 days	1,500
(c) Share pool 3,000 out of 4,650 (W)	3,000
	<hr/> 4,500 <hr/>

Capital gains computation

	£	£
(1) Shares acquired 28 January 2024		
Proceeds $(1,500/4,500) \times £22,500$	7,500	
Less: Cost	(3,000)	
	<hr/>	4,500
(2) Shares in share pool		
Proceeds $(3,000/4,500) \times £22,500$	15,000	
Less: Cost (W)	(3,065)	
	<hr/>	11,935
Total chargeable gains		16,435
Less: AEA		(6,000)
		<hr/> 10,435 <hr/>
Taxable gains		

Working: Share pool

		Number	Cost £
April 2000	Purchase	1,500	900
June 2003	Rights issue (1:3) × 70p	500	350
		<hr/>	<hr/>
		2,000	1,250
May 2012	Purchase	1,000	2,000
		<hr/>	<hr/>
		3,000	3,250
July 2012	Bonus issue (1:4)	750	0
		<hr/>	<hr/>
		3,750	3,250
August 2016	Purchase	900	1,500
		<hr/>	<hr/>
		4,650	4,750
December 2023	Sale	(3,000)	(3,065)
		<hr/>	<hr/>
Balance c/f		1,650	1,685
		<hr/>	<hr/>

**Test your understanding 3****Mustafa****(a) Gain on the sale of rights nil paid – 25 August 2023**

Sale proceeds received = £6,000

Value of shares after rights issue = (£2.65 × 12,000) = £31,800

5% × £31,800 = £1,590

The sale proceeds are > £3,000 **and** > 5% of the value of the shares on which the rights are offered, therefore there is a part disposal of the original shares held:

	£
Sale proceeds	6,000
Less: Allowable cost	
(£6,000/(£6,000 + £31,800) × £24,000)	(3,810)
	<hr/>
Chargeable gain	2,190
	<hr/>

Gain on the sale of the original shares – 23 June 2024

	£
Sale proceeds	37,000
Less: Allowable cost	
10,000/12,000 × (£24,000 – £3,810)	(16,825)
	<hr/>
Chargeable gain	20,175
	<hr/>

(b) Gain on the sale of rights nil paid – 25 August 2023

Sale proceeds received = £1,500.

The sale proceeds are < £3,000 therefore no gain arises on the sale of rights nil paid.

The sale proceeds are deducted from the cost of the original shares.

Note: There is no need to consider the 5% rule if the sale proceeds are < £3,000. Only one of the conditions needs to be satisfied.

Gain on the sale of the original shares – 23 June 2024

	£
Sale proceeds	37,000
Less: Allowable cost (W)	(18,750)
	<hr/>
Capital gain	18,250
	<hr/>

Working: Share pool

		Number	Cost £
22 July 2002	Purchase	12,000	24,000
25 August 2023	Sale of rights nil paid		(1,500)
		<hr/>	<hr/>
		12,000	22,500
23 June 2024	Sale of shares	(10,000)	(18,750)
		<hr/>	<hr/>
	Balance c/f	2,000	3,750
		<hr/>	<hr/>



Test your understanding 4

Milena

Disposal in December 2023

	£
Disposal proceeds	8,000
Less: Cost (W)	(4,000)
	<hr/>
Chargeable gain	4,000
	<hr/>

Working: Cost of 'A' ordinary shares

July 2023 Milena received:

4,000 'A' ordinary shares, valued at (4,000 × £2)	£8,000
2,000 preference shares, valued at (2,000 × £1)	£2,000

Cost attributable to the 'A' ordinary shares is therefore:

$$£5,000 \times (£8,000/£10,000) = £4,000$$



Test your understanding 5

Victoria

	MV Jan 2024	Cost
Exchanged assets:	£	£
30,000 ordinary shares (£15,000 × 90/115)	90,000	11,739
10,000 preference shares (£15,000 × 15/115)	15,000	1,957
£10,000 cash (£15,000 × 10/115)	10,000	1,304
	<hr/>	<hr/>
	115,000	15,000
	<hr/>	<hr/>

Is the cash element material? = Yes

- The cash received is £10,000 which is > £3,000.
- The cash element also represents > 5% of the total value of exchanged assets (£115,000 × 5% = £5,750).

A chargeable gain is taxable in the tax year 2023/24 based on the part disposal of the shares as follows:

	£
Sales proceeds	10,000
Less: Cost	(1,304)
	<hr/>
Chargeable gain	8,696
Less: AEA	(6,000)
	<hr/>
Taxable gain	2,696
	<hr/>
Capital gains tax (£2,696 × 20%)	539
	<hr/>

Victoria is a higher rate taxpayer, so the gain is taxed at 20%. BADR is not available as she has never worked for the company.



Test your understanding 6

Jasper

(a) Chargeable gains – 2023/24

Apportionment of cost of Cawte plc shares to the new securities and cash on 5 December 2023

For 12,000 Cawte plc ord shares:

	Purchase consideration £	Cost allocation £
12,000 Grasp £1 ord shs @ 350p	42,000	
£15,700 × (£42,000/£73,200)		9,008
24,000 Grasp 10% £1 loan note @ 110p	26,400	
£15,700 × (£26,400/£73,200)		5,662
Cash (12,000 × 40p)	4,800	
£15,700 × (£4,800/£73,200)		1,030
	<hr/>	<hr/>
	73,200	15,700
	<hr/>	<hr/>

Cash consideration of £4,800 exceeds £3,000 and exceeds £3,660 (5% of £73,200). Therefore, cash consideration is not small and the part disposal rules apply.

	£	£
Disposal for cash		
Cash received		4,800
Less: Deemed cost		(1,030)
		<hr/>
Chargeable gain		3,770
 Disposal for QCBs (loan notes)		
Value of loan notes received	26,400	
Less: Deemed cost	(5,662)	
	<hr/>	
'Frozen' gain	20,738	
	<hr/>	
Taxable at time of takeover		0
 Disposal of Grasp plc shares – 31 March 2024		
Proceeds	3,600	
Less: Deemed cost (£9,008 × 400/12,000)	(300)	
	<hr/>	
		3,300
		<hr/>
Total chargeable gains – 2023/24		7,070
		<hr/>

(b) **Selling the QCBs (loan notes) – June 2025**

If Jasper were to sell the loan notes in June 2025 for £32,000, the increase in value of the loan notes of £5,600 (£32,000 – £26,400) is exempt from CGT as QCBs are exempt assets.

However, the disposal of the loan notes will crystallise the 'frozen' deferred gain of £20,738 in the tax year 2025/26.



Test your understanding 7

Artem

On the liquidation of the company, the shareholders are treated as having sold their shares for proceeds equal to the amount received on the liquidation and a normal capital gain/loss computation is required.

In this case, Artem will make a capital loss on the disposal of his shares.

Artem can make a negligible value claim as at 1 December 2023. This will give rise to a capital loss of £14,500 (£500 – £15,000) which will be deemed to arise in the tax year 2023/24.

As the capital loss arises on the disposal of unquoted trading company shares and Artem subscribed for the shares, relief against income is available.

Artem can relieve the loss against his total income for:

- 2023/24 (i.e. the year in which the loss arose), and/or
- 2022/23 (i.e. the previous tax year).

If losses are first relieved against current year income, any excess is available for offset against the prior year's income.

By making the claim, Artem's total income in the tax year 2023/24 will be reduced to £30,500 (£45,000 – £14,500).



Test your understanding 8

Katya

	£
(a) Summit Ltd ($0.5\% \times £10,230$) = £51.15, round up to nearest £5	55
(b) Harcourts Ltd ($0.5\% \times (£125,000 + £35,000)$)	800
(c) Treasury stock – Exempt	0
	<hr/>
Total stamp duty payable	855
	<hr/>

CGT: Relief for individuals

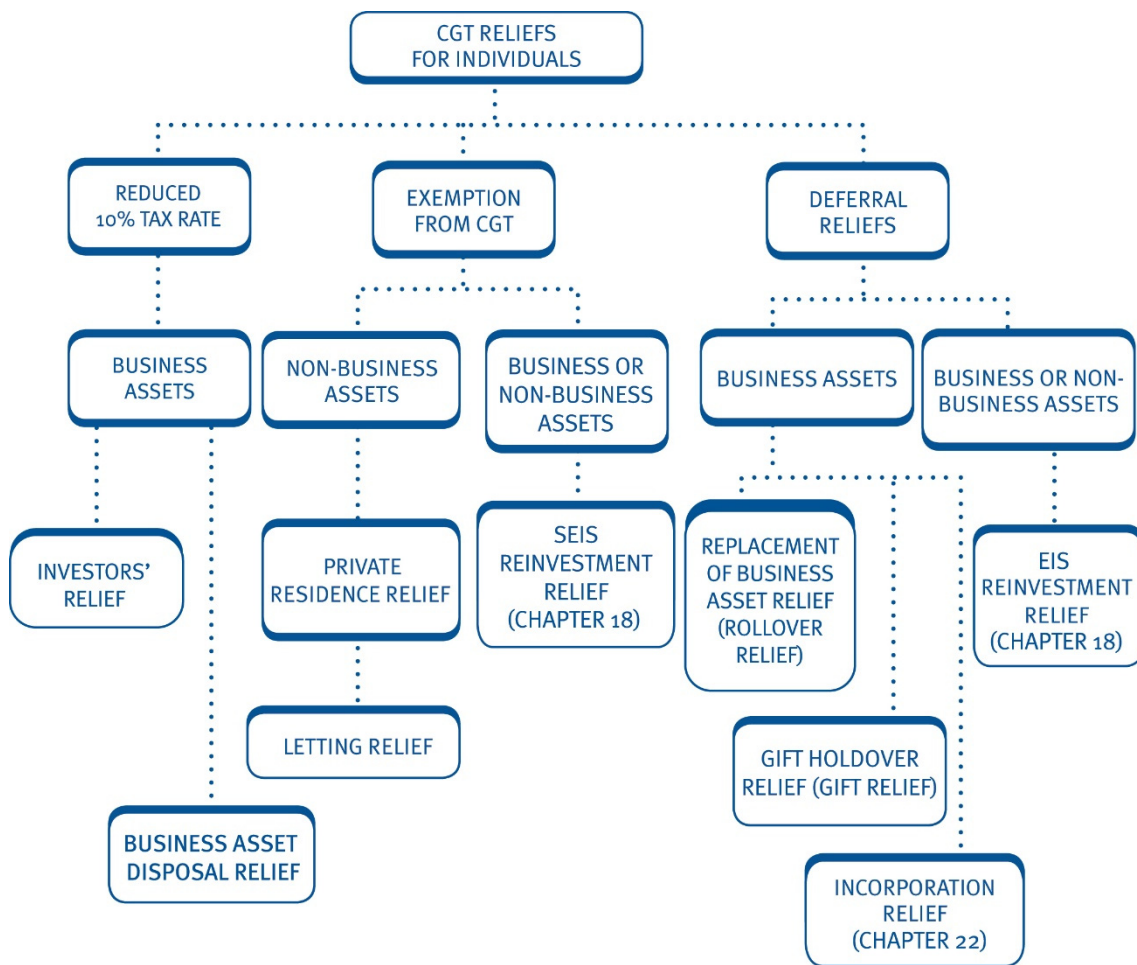
Chapter learning objectives

Upon completion of this chapter you will be able to:

- advise on the availability of business asset disposal relief in relation to associated disposals
- identify the private residence relief and letting relief available in a variety of circumstances on the disposal of an individual's main residence
- explain and apply rollover relief as it applies to individuals
- identify from a scenario when gift holdover relief will be available, explain the conditions and show the application of gift holdover relief in computations.



One of the PER performance objectives (PO17) is to advise on mitigating and deferring tax liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

After calculating the gains on disposals of individual assets, consideration must be given to the availability of CGT reliefs.



Much of this chapter is a revision of TX knowledge with examples to check your retention of the required TX knowledge. However, note that a greater depth of understanding is required at ATX.

The reliefs feature regularly in the examinations and the main new reliefs introduced at ATX are incorporation relief, EIS and SEIS reinvestment relief. These new reliefs are covered in detail in Chapter 22 and Chapter 18.

It is important to be able to calculate the amount of relief, to state the conditions that have to be satisfied and to explain the tax implications of claiming each relief.



Exam questions involving CGT reliefs could test several professional skills, such as: your ability to analyse information and evaluate possible reliefs, your communication skills in explaining the tax implications to your client using non-technical language and also your commercial acumen in relation to advising on the most appropriate way to structure disposals.

1 Summary of reliefs

Business asset disposal relief (BADR) and investors' relief (IR) tax certain gains at 10%. If BADR or IR do not apply, gains are only taxed at 10% where they fall within the taxpayer's remaining basic rate band. Gains in excess of this are taxed at 20%.

The other reliefs either exempt, or defer to a later date, all or part of the gain.

Deferral reliefs	Exemptions
<ul style="list-style-type: none"> • Replacement of business asset relief (rollover relief) • Gift holdover relief (gift relief) • Incorporation relief • EIS reinvestment relief 	<ul style="list-style-type: none"> • Private residence relief (PRR) • Letting relief • SEIS reinvestment relief

2 Business asset disposal relief and investors' relief

Business asset disposal relief

Business asset disposal relief (BADR) reduces the rate of CGT payable on certain qualifying business disposals to 10%.

A reminder of how the relief operates is given below and is summarised in the diagram at the end of this section.



Operation of the relief

- The first £1 million of gains on 'qualifying business disposals' will be taxed at 10%, regardless of the level of the taxpayer's income.
- Any gains above the £1 million limit are taxed in full at 10% or 20% (18% or 28% in the case of residential property) depending on the individual's taxable income.
- Gains qualifying for BADR are set against any unused basic rate band (BRB) before non-qualifying gains.
- The 10% CGT rate is calculated after the deduction of:
 - allowable losses, and
 - the annual exempt amount (AEA).
- However, the taxpayer can choose to set losses (other than any losses on assets that are part of the disposal of the business) and the AEA against non-qualifying gains first, in order to maximise the relief.
- It is therefore helpful to keep gains that qualify for BADR separate from those that do not qualify.

The relief must be claimed within 12 months of the 31 January following the end of the tax year in which the disposal is made.

For 2023/24 disposals, the relief must be claimed by 31 January 2026.

The £1 million limit is a lifetime limit which is diminished each time a claim for the relief is made.



Qualifying business disposals

The relief applies to the disposal of:

- the whole or substantial part of a business carried on by the individual either alone or in partnership
- assets of the individual's or partnership's trading business that has **now ceased**
- shares provided:
 - the shares are in the individual's 'personal trading company', **and**
 - the individual is an employee of the company (part time or full time).

An individual's 'personal trading company' is one in which the individual:

- owns at least 5% of the ordinary shares

Note in particular that:

- the disposal of an individual business asset used for the purposes of a continuing trade does not qualify. There must be a disposal of the whole of the trading business or a substantial part (meaning part of the business which is capable of separate operation). The sale of an asset in isolation will not qualify.
- Where the disposal is a disposal of assets (i.e. not shares), relief is not available on gains arising from the disposal of those assets held for investment purposes.
- There is no requirement to restrict the gains qualifying for relief on shares by reference to any non-business assets held by the company.
- There are no rules about the minimum working hours of officers or employees; they just need to be an officer or employee throughout the two-year qualifying ownership period (see below). Note also that non-executive directors and company secretaries will qualify as employees.
- For shares acquired under tax advantaged EMI share option schemes (see Chapter 17) there is no requirement to hold $\geq 5\%$ shareholding.



Restriction of BADR in respect of goodwill

Gains in respect of goodwill will not qualify for BADR if an individual transfers the goodwill to a close company (see Chapter 24) as part of a business disposal and immediately after the disposal the individual is a shareholder in the company.

This restriction does not apply where the individual:

- holds less than 5% of the company's ordinary share capital and voting rights, or
- holds 5% or more of the company's ordinary share capital or voting rights, but sells the whole shareholding to an unconnected company within 28 days. The individual must hold less than 5% of the acquiring company's ordinary share capital and voting rights. This means that BADR will be available on goodwill gains where an individual incorporates a business in order to sell the newly incorporated company.



Qualifying ownership period

In the case of the disposal of a business it must have been owned by the individual making the disposal for the two years prior to the disposal.

In the case of shares the individual must also have been an employee of the company and the company must have been the individual's personal trading company for at least two years prior to the disposal.

Where the disposal is an asset of the individual's or partnership's trading business that has now ceased the disposal must also take place within three years of the cessation of trade. The business must have been carried on for at least two years prior to cessation.

For tax advantaged EMI share option schemes (Chapter 17) the two-year ownership period can be counted from the date the option is granted (not when the shares are acquired).

Qualifying ownership period for shares acquired on incorporation

For shares acquired through incorporation (Chapter 22), i.e. on the transfer of:

- all of the assets of an unincorporated business (or all except cash) to a company
- as a going concern
- in exchange wholly or partly for shares

the period of ownership of the unincorporated business can be counted towards the two-year ownership period for BADR on the disposal of the shares.



Illustration 1 – Business asset disposal relief

In the tax year 2023/24, Kim sold her trading business which she set up in 2002 to Martha and realised the following gains/losses:

	£
Factory	275,000
Goodwill	330,000
Warehouse	(100,000)
Investment property	200,000

All of the assets have been owned for many years.

Kim also sold her shares in an unquoted trading company and realised a gain of £600,000. She owned 25% of the ordinary shares of the company which she purchased ten years ago. She has worked for the company on a part time basis for the last three years.

Kim has not made any other capital disposals in the tax year 2023/24, but she has capital losses brought forward of £9,000. She has never claimed any business asset disposal relief in the past.

Her only source of income is a trading profit of £40,000.

Calculate Kim's capital gains tax payable for the tax year 2023/24.

Solution

	Qualifying for BADR	Not Qualifying for BADR
	£	£
Sale of investment property (Note 1)		200,000
Sale of trading business:		
Factory	275,000	
Goodwill	330,000	
Warehouse (Note 2)	(100,000)	
	<hr/>	
	505,000	
Sale of trading company shares (Note 3)	495,000	105,000
	<hr/>	<hr/>
	1,000,000	305,000
Less: AEA (Note 4)	(0)	(6,000)
Less: Capital losses b/f (Note 4)	(0)	(9,000)
	<hr/>	<hr/>
Taxable gains	1,000,000	290,000
	<hr/>	<hr/>

		£
Capital gains tax (Note 6)		
Qualifying gains	(£1,000,000 × 10%)	100,000
Non-qualifying gains	(£290,000 × 20%)	58,000
		<hr/>
		158,000
		<hr/>

Notes:

- (1) Despite being part of the sale of the whole business, the gain arising on the investment property does not qualify for BADR.
- (2) The net chargeable gains on the disposal of an unincorporated business qualify for BADR (i.e. the gains after netting off all losses arising on the disposal of the business, but excluding investment assets).
- (3) After the first £1,000,000 of gains qualifying for BADR have been taxed at 10%, any remaining gains do not qualify and are taxed at the appropriate rate depending on the individual's taxable income.
- (4) Capital losses and the AEA are first set against gains not qualifying for BADR.
- (5) Kim's taxable income is £27,430 (£40,000 – £12,570 PA). Therefore, the BR band remaining is £10,270 (£37,700 – £27,430).
- (6) The gains qualifying for BADR are deemed to utilise the BR band first. Therefore, the BR band remaining of £10,270 is set against the gains qualifying for BADR leaving the remaining gains to be taxed at 20%.

Note: There is no need to calculate the BR band in this case because even if Kim had no taxable income, the gains qualifying for BADR (£1,000,000) are > £37,700. Therefore, the non-qualifying gains must be taxed at 20%.

**Test your understanding 1**

In the tax year 2023/24 Paolo sold shares in Dual Ltd, an unquoted trading company, and realised a gain of £430,000. Paolo has worked for Dual Ltd for many years and has owned 10% of the ordinary shares of the company for the last five years.

Paolo set up a trading business in 2015 and in the tax year 2023/24 he sold a warehouse used in the business, realising a gain of £245,000.

Paolo's trading income was £38,000 in the tax year 2023/24. He did not have any other source of income.

In the tax year 2024/25 Paolo sold the rest of the business to another sole trader and realised the following gains:

Factory	£395,000
Goodwill	£130,000

All of the assets in the business have been owned for many years.

Paolo also sold an antique table in the tax year 2024/25 and realised a gain of £5,325.

His trading profit in the tax year 2024/25 was £55,000 and prior to 2023/24 Paolo has claimed business asset disposal relief of £200,000.

Calculate Paolo's CGT payable for the tax years 2023/24 and 2024/25 and state when this tax is due.

Assume that the rates and allowances for the tax year 2023/24 continue in the future.



Associated disposals

BADR also applies to assets owned by an individual and used in the individual's personal trading company or trading partnership **provided**:

- the individual also disposes of all or part of the partnership interest/shares
- as part of the individual's withdrawal of involvement in the partnership/company business.

These disposals are referred to as associated disposals.

In order for relief to be available for associated disposals, the individual must not have charged rent to the business for the use of the assets.

Where a full market rent has been charged, the relief available is reduced to nil.

Where the rent paid is less than the market rate, the relief is restricted on a 'just and reasonable basis'.



Illustration 2 – Associated disposals

Lex has been a partner in the Luther partnership since 1 April 2017. Lex retired on 1 April 2024, selling his share of the partnership to the remaining partners. The gain arising on the disposal of Lex's partnership interest qualifies for BADR.

Throughout the time Lex was a partner he allowed the Luther partnership to use a warehouse he owned personally as its business premises in return for a rent which was 75% of the market rate. The warehouse was sold to the remaining partners on 1 April 2024, resulting in a chargeable gain of £150,000.

The disposal of the warehouse will qualify for BADR as an associated disposal, but relief will only be available for £37,500 ($£150,000 \times 25\%$) as Lex has charged rent at 75% of the market rate ($100\% - 75\% = 25\%$).



Interaction with enterprise investment scheme (EIS)

Gains qualifying for BADR that are deferred via an investment in EIS shares will still qualify for BADR on becoming chargeable.

More detail is given in Chapter 18.

Investors' relief

As explained above, BADR is only available on a disposal of shares if the shares are in the individual's personal company (the individual holds 5% of the shares) and the individual is also an officer or employee of the company.

Investors' relief (IR) was introduced to extend the benefits of BADR to certain investors who do not meet the conditions for BADR.

IR applies to the disposal of:

- unlisted ordinary shares in a trading company (including AIM shares)
- subscribed for (i.e. newly issued shares) on/after 17 March 2016
- which have been held for a minimum period of three years starting on 6 April 2016
- by an individual that is **not** an employee of the company.

IR is subject to a lifetime limit of £10 million of qualifying gains which are taxed at 10%.



Test your understanding 2

Nikita sold all of her shares in Sahara Ltd on 31 January 2024, realising a chargeable gain of £13 million.

She had originally subscribed for the shares in cash on 5 August 2020 when the company issued new shares in order to raise money to expand its manufacturing into other areas of the UK.

Nikita has taxable income of £60,000 and has never worked for Sahara Ltd.

Calculate Nikita's CGT payable for the tax year 2023/24.

Interaction with other reliefs

Note that other specific CGT reliefs (e.g. gift holdover relief, rollover relief and incorporation relief) are given before considering BADR or IR.

More detail on how the interaction between reliefs works is given later with the detail on the specific reliefs.

Interaction with takeovers

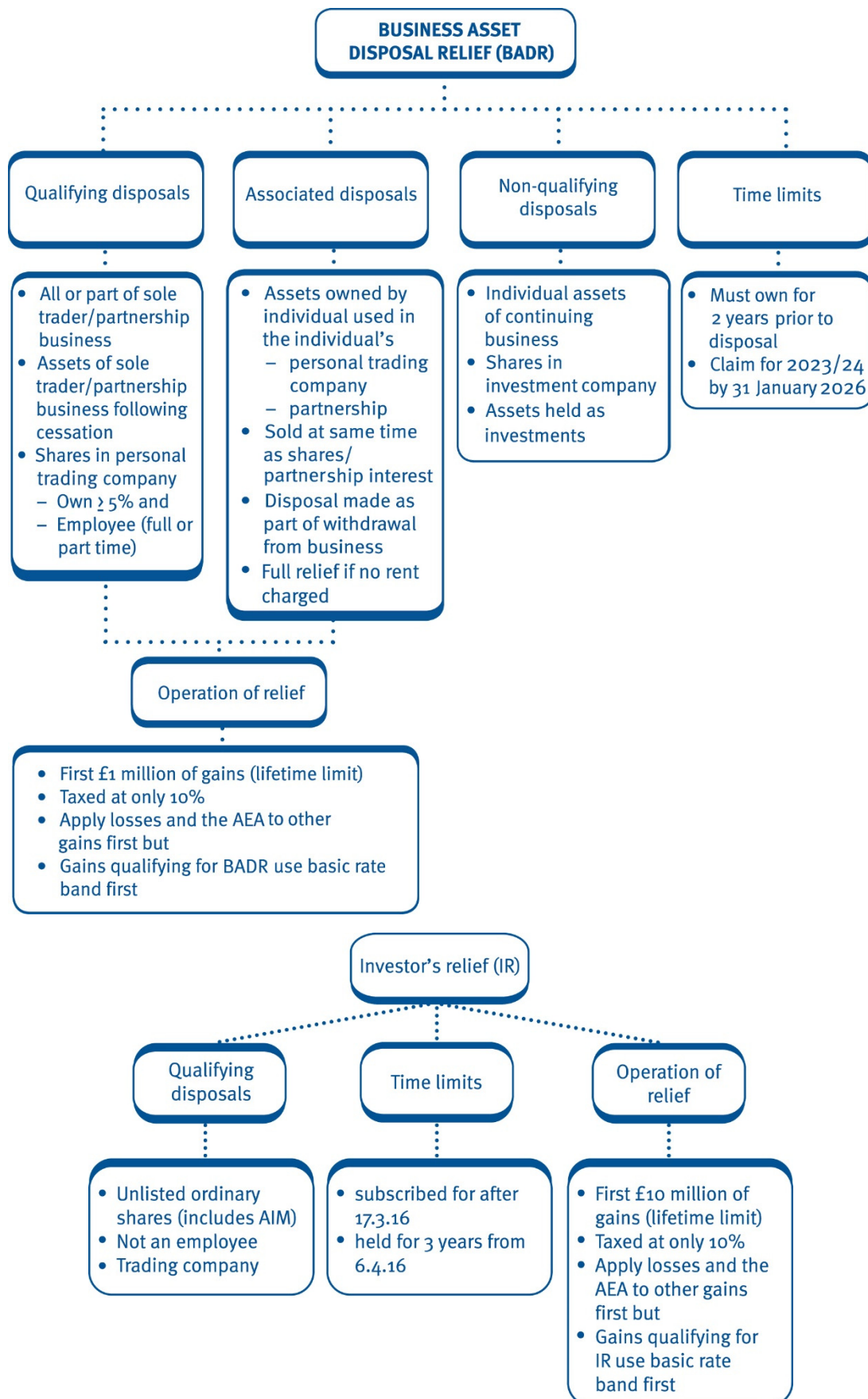
With a share for share exchange, it is possible that:

- the old shares would qualify for BADR or IR if it were treated as a disposal
- but the new shareholding and so the later disposal of the shares would not qualify for relief.

However, where the share for share exchange takes place, the individual shareholder can:

- elect for the event to be treated as a disposal for CGT purposes, and
- claim BADR or IR (i.e. tax the gain at 10%).

Summary



3 Private residence relief (PRR) and letting relief



Tax status

The disposal of UK residential property is a chargeable disposal but PRR may be available.

Non-UK resident individuals are only liable to capital gains tax on UK residential property gains arising after 5 April 2015. These rules are covered in Chapter 20.

Private residence relief

PRR exempts all or part of the gain arising on the disposal of residential property.

It applies when an individual disposes of:

- a dwelling house (including normally up to half a hectare of adjoining land)
- that has at some time during the individual's ownership been the individual's only or main private residence.

There are three possible scenarios to consider:

Occupation of the house	Consequence for CGT
1 The owner occupies the residence throughout the whole period of ownership	<ul style="list-style-type: none"> • Gain is exempt
2 The owner is absent from the residence for certain periods	<ul style="list-style-type: none"> • Calculate gain • PRR available
3 Part of the main residence is let out (with the owner occupying the rest of the property)	<ul style="list-style-type: none"> • Calculate gain • PRR available • Letting relief



The meaning of 'dwelling house'

The meaning of 'dwelling house' is not defined in the legislation and so it has been left to the courts to determine the limits of the expression.

A number of principles have emerged from decided cases:

- Caravans connected to mains services such as electricity and water qualify as dwellings.
- A taxpayer sold a bungalow and a small amount of land that was within the grounds of the taxpayer's house and which had been occupied by a part-time caretaker. It was held that the bungalow provided services for the benefit of the main house, was occupied by the taxpayer through the employee of the taxpayer, and so qualified as part of the taxpayer's residence.

A test resulting from this case is that buildings must together form an entity that can be regarded as a dwelling house, albeit divided into different buildings performing different functions.

- Where a taxpayer owns a large property, which is divided into several self-contained units, only those parts that the taxpayer actually occupies qualify for exemption.
- A taxpayer first sold a house and part of the garden and then, about a year later, sold the remainder of the garden at a substantial profit. It was held that the PRR exemption applied only to the first disposal, because when the remainder of the land was sold, it no longer formed part of the individual's private residence. It is possible that if the order of sales were reversed, the land sold independently of the buildings may not qualify for relief, but is likely to depend on the facts of the case and the size and purpose of the land sold.



Ownership of more than one residence

Where an individual has more than one residence the individual can nominate which of them is to be treated as the principal residence for capital gains tax purposes by notifying HMRC in writing.

The election must be made within two years of acquiring an additional residence otherwise it is open to HMRC, as a question of fact, to decide which residence is the main residence.



Married couples and civil partners

Provided that they are not treated as being separated or divorced, a married couple or civil partnership is entitled to only one residence between them for the purposes of PRR.

The operation of the relief

Where there has been a period of absence from the private residence the procedure is:

- Calculate the gain on the disposal of the property.
- Calculate the total period of ownership.
- Calculate periods of occupation (see below).
- Calculate the amount of PRR as follows:

$$\text{Gain} \times (\text{Periods of occupation} \div \text{Total period of ownership})$$

- If applicable, calculate the amount of letting relief available.

Periods of occupation

The 'periods of occupation' include:

- **any** period of **actual** occupation
- the **last nine months** of ownership (always exempt, unconditionally)
- the following periods of **deemed occupation**:
 - (i) periods totalling up to **three years** of absence for any **reason**
 - (ii) **any** period spent living overseas due to employment
 - (iii) periods totalling up to **four years** of absence in which the individual was **prevented from living in the UK property** because:
 - an employer required the individual to live elsewhere in the UK and the individual's place of work was too far from the property, or
 - the individual was self-employed, and was required to live elsewhere in the UK or overseas due to the self-employment business.

Note that:

- The periods of deemed occupation above must be preceded and followed by a period of actual occupation.
- The condition to actually reoccupy the property after the period of absence does not need to be satisfied for periods (ii) and (iii) above where the individual was unable to resume residence because the terms of employment required the individual to work elsewhere.



- Note that there are different rules relating to the definition of occupation and non-occupation where:
 - a non-UK resident individual has a property in the UK, or
 - a UK resident individual has a non-UK residential property
 - on which PRR is to be claimed.

These rules are considered in more detail in Chapter 20. However, in this chapter it is assumed that all examples involve UK resident individuals disposing of UK residential properties, and therefore the 'periods of occupation' are as stated above.



Illustration 3 – PRR

On 1 May 1998 Janette purchased a house in Southampton for £125,000, which she lived in until she moved to a rented flat on 1 July 1999.

She remained in the flat until 1 October 2001 when she accepted a year's secondment to her firm's New York office. She returned to the UK on 1 October 2002 and moved into a relative's house, where she stayed until she returned to her own home on 31 January 2003.

On 1 July 2013 she moved in with her girlfriend in Newcastle. Here she remained until she sold her Southampton house on 1 February 2024 for £350,000.

Calculate the chargeable gain, if any, arising on the disposal of the house on 1 February 2024.

Solution

	£
Disposal proceeds	350,000
Less: Cost	(125,000)
	<hr/> 225,000
Less: PRR (W)	(139,078)
	<hr/> 85,922
Chargeable gain	<hr/>

Working – Chargeable and exempt periods of ownership

		Chargeable months	Exempt months
1.5.98 – 30.6.99	(actual occupation)	–	14
1.7.99 – 30.9.01	(absent – any reason)	–	27
1.10.01 – 30.9.02	(absent – employed abroad)	–	12
1.10.02 – 31.1.03	(absent – any reason)	–	4
1.2.03 – 30.6.13	(actual occupation)	–	125
1.7.13 – 30.4.23	(absent – see note (1))	118	–
1.5.23 – 31.1.24	(final nine months)	–	9
		<hr/> 118	<hr/> 191
		<hr/>	<hr/>

Total period of ownership = $(118 + 191) = 309$ months. Exempt element of gain = $(191/309) \times £225,000 = £139,078$

Notes:

- (1) After Janette left her house to live in Newcastle she never returned. Consequently, the remaining 5 months (3 years – 27 months – 4 months) for any reason is not available for exemption as she did not meet the condition of actual occupation both before and after the period of absence.
- (2) In contrast the exemption for the final nine months of ownership has no such restriction and is therefore still available.

Letting relief

Letting relief is available where an individual's private residence is let for residential use.

It applies when the owner lets part of the property whilst still occupying the remainder. Letting relief is not available where the owner is absent from the property and lets the property out.

If the owner has one lodger who lives as a member of the owner's family, sharing the accommodation and taking meals with them, then full PRR will be available and letting relief will not be considered.

It does not apply to let property that is not the owner's private residence (e.g. buy-to-let properties).

Letting relief is the lowest of:

- (i) £40,000
- (ii) the amount of the gain exempted by the normal PRR rules
- (iii) the part of the gain **after PRR** attributable to the letting period.

**Test your understanding 3**

Alfonso bought a house on 1 April 1998. Occupation of the house has been as follows:

1.4.98 – 31.3.00	lived in the house as his private residence.
1.4.00 – 30.9.05	travels the world and lets the house.
1.10.05 – 31.3.14	lived in the house as his private residence.
1.4.14 – 31.3.24	lived in two thirds and rented one third

Whilst the house was rented the tenants did not share any living space with Alfonso.

On 31 March 2024 Alfonso sells the house realising a gain before relief of £194,800.

Calculate the chargeable gain in the tax year 2023/24.

Business use

Where a house, or part of it, is used wholly and exclusively for business purposes, the part used for business purposes is not eligible for PRR.

Note that:

- the taxpayer cannot benefit from the rules of deemed occupation for any part of the property used for business purposes
- there is one exception:
 - if that part of the property used for business purposes was at any time used as the taxpayer's main residence, the exemption for the last nine months still applies to that part
 - this exception does not apply to any part of the property used for business purposes throughout the whole period of ownership.



Test your understanding 4

On 31 July 2023 Alex sold his house for £125,000, resulting in a capital gain of £70,000. The house had been purchased on 1 July 2011, and one of the five rooms had been used for business purposes from 1 January 2014 to the date of sale.

Calculate the chargeable gain arising on the sale of the house.

Tax planning points

General advice

CGT planning concerning an individual's private residence focuses on two main areas:

- If the taxpayer's circumstances are such that any gain realised will be exempt, the taxpayer should ensure that this is maximised. However, if a loss were to be realised then this would not be allowable, so in this case the relief should be minimised.
- Where the taxpayer is absent from the property the taxpayer should attempt to structure the absences in such a way that the taxpayer benefits as much as possible from the deemed occupation rules.

For example, ensure:

- taxpayer reoccupies the property after the period of absence

Specific tax advice

Rate of tax

Any taxable gains arising on the sale of residential property (i.e. gains that are not covered by PRR or letting relief) will be subject to CGT at a rate of 18% (if the gains fall within any remaining basic rate band) or 28% rather than the normal rates of CGT.

If taxpayers have both chargeable gains arising from the sale of residential property and other chargeable gains, any capital losses and the AEA should be allocated first to the residential property gains as these will be taxed at higher rates than other gains.

More than one residence

Where the taxpayer has more than one residence the property with the greatest potential for gain should be nominated as the main residence.

It should be noted, however, that any property subject to an election must be used at some time as the taxpayer's residence. It is not acceptable to purchase a property as a financial investment, nominate it as the main residence of the taxpayer, and never set foot in it.

If an individual's finances permit, the individual should purchase a new residence before disposing of the old one. An election can be made for the new residence to be treated as the main residence for the CGT exemption but this does not prevent exemption being gained on the old residence for the final nine months of ownership.

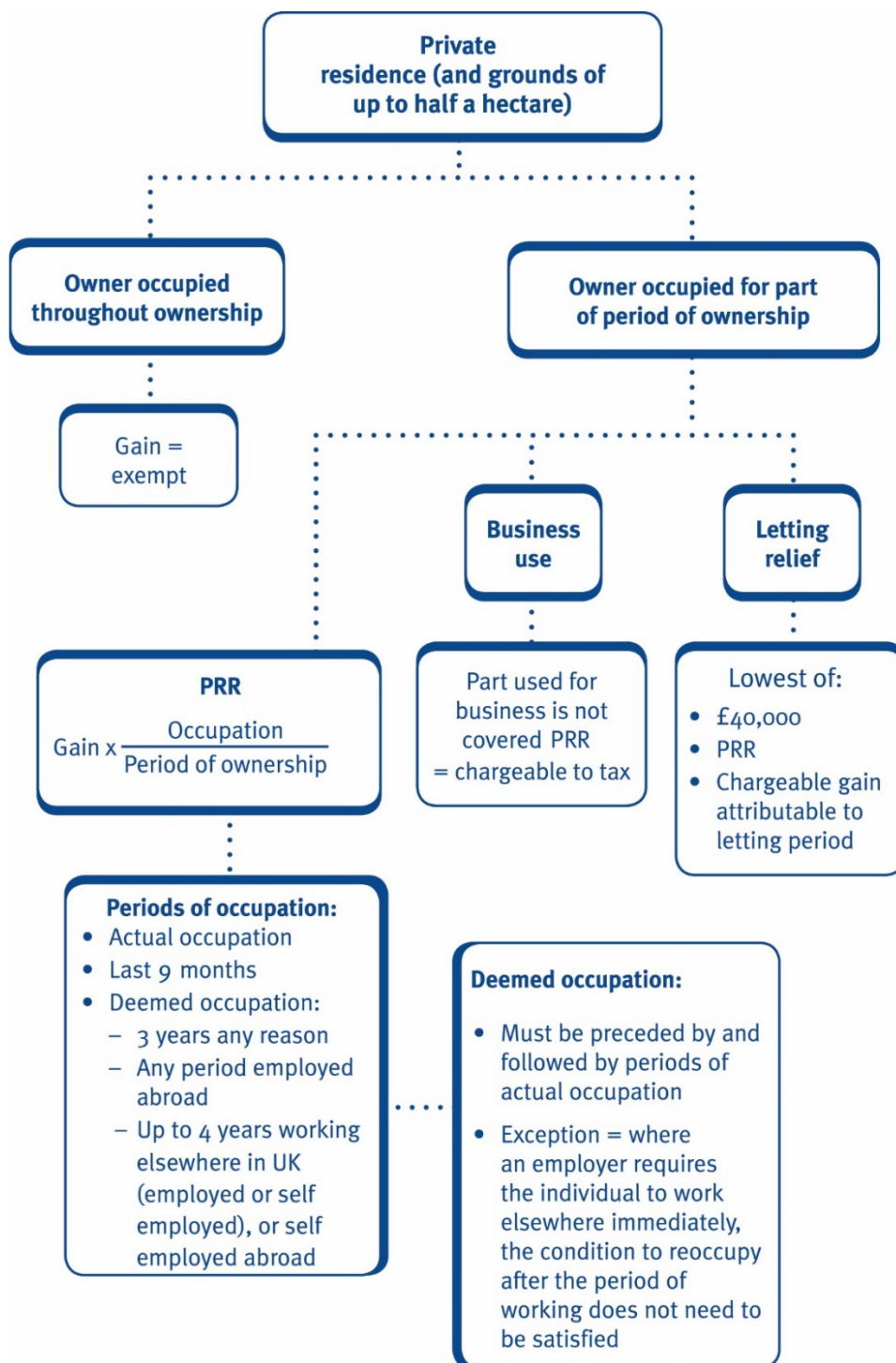
In this way the taxpayer can effectively gain exemption on two residences at once for a maximum of nine months.

Business use of property

Subject to tax and other financial considerations, exclusive business use of the property should be avoided.

Where business use is necessary, thought should be given to the proportion of household expenses claimed under the income tax rules because these will be a material factor in determining the extent to which the PRR is lost.

Summary



4 Comprehensive example



Test your understanding 5

Pascha disposed of the following assets during the tax year 2023/24:

- (1) On 10 July 2023 Pascha sold 5,000 £1 ordinary shares in Symphony Ltd, an unquoted trading company, for £23,600. He had originally purchased 40,000 shares in the company on 23 June 2020 for £110,400 from a previous shareholder. Pascha's shareholding is equal to 2.5% of share capital.
- (2) On 15 July 2023 Pascha made a gift of his entire shareholding of 10,000 £1 ordinary shares in Concerto plc to his daughter. On that date the shares were quoted on the Stock Exchange at £5.10 – £5.18. Pascha's shareholding had been purchased on 29 April 2005 for £14,000. The shareholding is less than 1% of Concerto plc's issued share capital, and Pascha has never been employed by Concerto plc.
- (3) On 9 August 2023 Pascha sold a car for £16,400. The car had been purchased on 21 January 2018 for £12,800.
- (4) On 4 October 2023 Pascha sold an antique vase for £12,400. The antique vase had been purchased on 19 January 2020 for £8,400.
- (5) On 31 December 2023 Pascha sold a house for £220,000. The house had been purchased on 1 April 2016 for £114,700. Pascha occupied the house as his main residence from the date of purchase until 30 June 2019. The house was then unoccupied until it was sold on 31 December 2023.
- (6) On 16 February 2024 Pascha sold three hectares of land for £285,000. He had originally purchased four hectares of land on 17 July 2020 for £220,000. The market value of the unsold hectare of land as at 16 February 2024 was £90,000. The land has never been used for business purposes.
- (7) On 5 March 2024 Pascha sold a freehold holiday cottage for £125,000. The cottage had originally been purchased on 28 July 2019 for £101,600 by Pascha's wife. She transferred the cottage to Pascha on 16 November 2022 when it was valued at £114,800.
- (8) Pascha has taxable income for the tax year 2023/24 of £28,200.

Compute Pascha's CGT liability for the tax year 2023/24, and advise him by when this should be paid.

5 Replacement of business asset relief (rollover relief)

Rollover relief (ROR) is available to both individuals and companies.

This section deals with the rules as they apply to an individual with an unincorporated business. The rules for companies are very similar but the differences are explained in Chapter 2.

The operation of the relief

Where an individual:

- sells a qualifying business asset at a gain, and
- reinvests the net sale proceeds in a replacement qualifying business asset
- within a qualifying time period

the individual may **make a claim** to defer the gain until the subsequent disposal of the replacement asset.



A reminder of how the relief operates and the conditions for the relief covered at TX is given below, and is summarised in the diagram at the end of this section.



Operation of the relief

The relief operates as follows:

- on the disposal of a business asset, the gain is 'rolled over' against (i.e. deducted from) the acquisition cost of the replacement asset
- provided the net proceeds (after deducting selling costs) are fully reinvested, no tax is payable at the time of the disposal as the gain is deferred
- the relief effectively increases the gain arising on the disposal of the replacement asset, as its base cost has been reduced by ROR
- ROR is not automatic, it must be claimed.

Note that:

- gains may be 'rolled over' a number of times provided a qualifying replacement business asset is purchased, therefore a tax liability will only arise when there is a disposal without replacement
- the relief is 'all or nothing' in that if the claim is made, the maximum gain possible must be deferred (i.e. a claim cannot be restricted to preserve the AEA)

- the relief is very flexible, where several assets are sold and several more acquired, the gains can be rolled over against the new assets in whatever order or proportion the individual chooses (but the full amount of gains must be deferred)
- making a ROR claim is optional. An individual may prefer to crystallise a gain in the current year if it is covered by capital losses and the AEA
- the base cost of the replacement asset is reduced for CGT purposes only.

Note that for income tax purposes, capital allowances (if applicable) are still available on the full cost of the replacement asset in the normal way.



Conditions of the relief

Qualifying business assets (QBAs)

There are many categories of QBAs, however for examination purposes, the main assets which qualify for ROR are:

- goodwill (for unincorporated businesses only)
- land and buildings (freehold and leasehold) occupied and used for trading purposes
- fixed plant and machinery (not movable).

Note that:

- shares are not qualifying assets for ROR purposes
- both the old and the replacement assets:
 - must be qualifying business assets, however they do not have to be the same category of qualifying asset
 - they do not have to be used in the same trade if the vendor has more than one trade.

Qualifying time period

The replacement assets must be acquired within a four-year period beginning **one year before** and ending **three years after** the date of sale of the old asset.

Claim time period

Individuals must claim ROR within four years of the **later of** the end of the tax year in which the:

- disposal is made (i.e. by 5 April 2028 for a disposal in the tax year 2023/24)
- replacement asset is acquired.



Partial reinvestment of proceeds

If **all** of the net sale proceeds from the sale of the old asset are reinvested, full ROR is available (i.e. **all** of the gain is deferred).

However, where there is partial reinvestment of the proceeds:

- part of the gain will be chargeable at the time of the disposal
- the rest of the gain can be deferred with a ROR claim.

The gain which is **chargeable** at the time of the disposal is the **lower** of:

- the full gain, or
- the amount of the proceeds **not** reinvested.

This gain will be taxed at either 10% or 20% depending on the level of the individual's taxable income.

Note that business asset disposal relief is not available on the disposal of individual assets (unless the disposal is on the cessation of the business).

The deferred gain will be taxed at the rate applicable when the gain is crystallised in the future.



Test your understanding 6

In May 1997, Katherine sold a freehold commercial building for £100,000 and realised a chargeable gain of £58,240.

In August 1997 Katherine bought another freehold commercial building for £80,000 which she sold in July 2023 for £300,000. She did not replace this building with any other business assets.

Calculate the chargeable gain arising in the tax year 2023/24.



Non-business use

Adjustments need to be made to the calculation of the amount of relief available if there is an element of non-business use. Only the business use proportion of the gain can be considered for ROR.

This may occur because:

- an asset may be used partly for business purposes and partly for private use
- an asset is not used for business purposes for the whole of the period of ownership.



Reinvestment in depreciating assets

A depreciating asset is defined as:

- a wasting asset (i.e. with a predictable life of 50 years or less), or
- an asset that will become a wasting asset within ten years.

The most common examples of qualifying depreciating assets are:

- leasehold land and buildings with 60 years or less to run on the lease
- fixed plant and machinery.

The operation of the relief

The relief for depreciating assets operates in the following way

- The capital gain is not 'rolled over' and deducted from the base cost of the replacement asset, instead it is deferred (i.e. 'frozen'), and becomes chargeable on the **earliest** of the following three events:
 - (1) the **disposal** of replacement depreciating asset
 - (2) the depreciating asset **ceases to be used** for the purposes of the trade
 - (3) **ten years** from the date of acquisition of the replacement depreciating asset.
- However, if before the deferred gain crystallises, a non-depreciating asset is purchased, then the original deferred gain can be rolled over.

This means that the deferred gain can be matched with the later purchase of a non-depreciating asset and the deferred gain will be deducted from the cost of the new asset.

Note that the partial reinvestment and non-business use rules apply in calculating the amount of the held over gain that can be deferred, in the same way as for rollover relief.



Illustration 4 – Reinvestment in depreciating assets

Selasi purchased a factory in February 2001 for £195,000.

In August 2023 he sold the factory for £380,000 and acquired a lease of commercial property (with 55 years to expiry) in September 2023 for £385,000.

In April 2024 he purchased a new factory for £390,000 and he sold the lease for £430,000 in December 2024. In May 2026 he sold the second factory for £425,000.

Calculate the chargeable gain on:

- the disposal of the first factory
- the disposal of the lease, and
- the disposal of the second factory.

Solution

(a) Gain on first factory – August 2023

	£
Disposal proceeds	380,000
Less: Cost	(195,000)
	<hr/>
Capital gain	185,000

As Selasi reinvested the proceeds of the first factory in a depreciating asset (i.e. the lease), the gain on the first factory is held over.

The gain is therefore frozen until the earliest of three events.

Chargeable gain = £0

(b) Disposal of the lease – December 2024

Selasi purchased another non-depreciating asset (i.e. the second factory) before the depreciating asset was sold. He could therefore rollover the gain on the first factory into the second, and a normal gain arises on the lease.

	£
Disposal proceeds	430,000
Less: Allowable expenditure (Note)	(385,000)
	<hr/>
Chargeable gain	45,000
	<hr/>

BADR is not available as this is the disposal of an individual asset used for the purposes of a continuing trade.

The base cost of the second factory becomes:

	£
Cost	390,000
Less: ROR	(185,000)
	<hr/>
Base cost	205,000
	<hr/>

Note: The lease, although a depreciating asset for ROR purposes, is not a wasting asset because it had more than 50 years to expiry when it was sold. Its cost is therefore not wasted when computing the gain or loss on disposal.

(c) **Disposal of second factory – May 2026**

	£
Disposal proceeds	425,000
Less: Base cost	(205,000)
	<hr/>
Chargeable gain	220,000
	<hr/>

BADR is not available as this is the disposal of an individual asset.

The gain will be taxed at the appropriate rate in the tax year 2026/27.

Assuming there is no change in rates for CGT, the gain will be taxed at 10% or 20%.

Interaction with business asset disposal relief

Business asset disposal relief is not available on the disposal of individual assets out of a business.

However, if the business is being sold and the proceeds are reinvested into new qualifying assets in another business, both ROR and BADR are available.

- ROR is given before considering BADR
- On a subsequent disposal of the replacement assets (as part of the sale of the other business as a whole) BADR will be available if the retention period of two years is met.

Effectively, the use of the lifetime relief of £1 million is also deferred.

However, ROR is optional and the taxpayer can choose **not to claim** ROR and utilise the available BADR earlier.



Test your understanding 7

Sophie operates a business as a sole trader. The business has a 31 March year end.

Sophie purchased an office block in October 2012 for £70,000 and sold it in August 2018 for £120,000. She acquired fixed plant and machinery at a cost of £100,000 in April 2019. The maximum possible rollover relief was claimed, in respect of the gain arising on the office block, against the purchase of the fixed plant and machinery.

In November 2023 Sophie sold the fixed plant and machinery for £60,000.

Calculate the Sophie's chargeable gain in the tax year 2023/24.

Tax planning points

Much of tax planning for replacement of business assets involves taking care to ensure that the various conditions are met.

- Disposals and acquisitions need to be planned well in advance to ensure that the time limit for reinvestment is adhered to. It may be necessary to advance or delay capital expenditure (where commercially possible).
- It is not possible to choose to defer only part of a gain leaving sufficient to cover the AEA. However, it may be possible to reinvest all but £6,000 of proceeds in replacement assets to avoid wasting the AEA.
- The interaction between ROR and BADR should also be considered carefully. It might not be advisable to defer gains on assets qualifying for BADR, if the new business may be held for a period of less than two years.



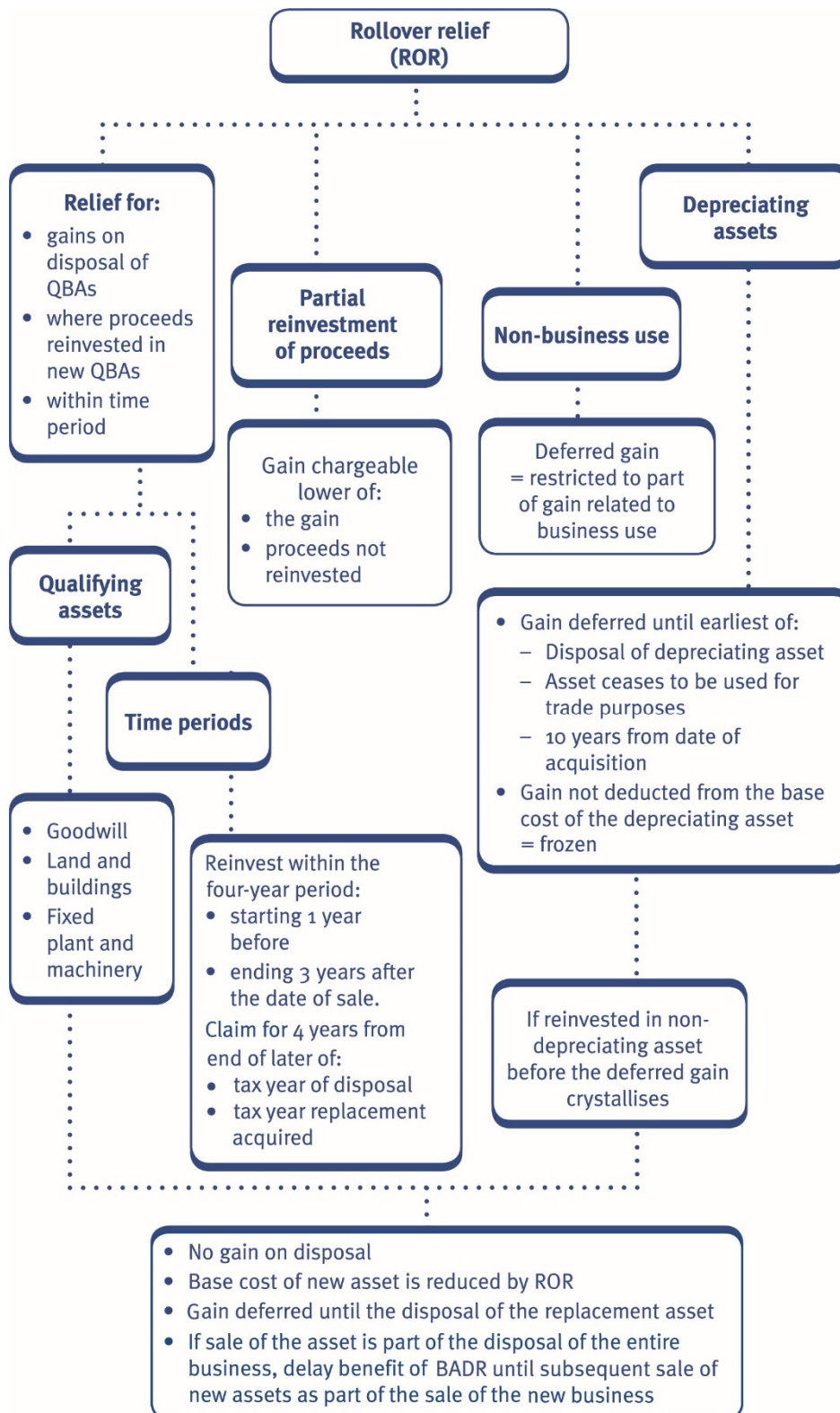
Test your understanding 8

Your client, Aneesha, has been offered £160,000 for a freehold factory she owns and is considering disposing of it in early October 2023. She acquired the factory for £40,000 on 31 March 1995. The sale of the factory is part of a disposal of the entire business.

Aneesha has taxable income of £70,000 per annum.

- Compute the capital gains tax that will arise if Aneesha disposes of the factory, and does not claim rollover relief.**
- Indicate to Aneesha the capital gains consequences of each of the following alternative courses of action she is considering taking, following the sale, and give any advice you consider to be relevant.**
 - acquiring a new freehold factory as part of a new business in 2024 for £172,000.**
 - acquiring a new freehold factory as part of a new business in 2024 for £155,000 and using the remainder of the proceeds as working capital.**

Summary



6 Gift holdover relief (gift relief)

Gift holdover relief (GR) applies to:

- lifetime gifts, and
- sales at undervaluation
- of qualifying assets.

The relief allows the gain on some lifetime gifts and some transactions that have an element of a gift (i.e. sales at undervaluation) to be deferred until the asset is subsequently disposed of by the recipient of the gift (i.e. the donee).



Note that gift relief will be referred to as 'gift holdover relief' in the ATX exam.

The operation of the relief



A reminder of the operation of the relief covered at TX is given below and is summarised in the diagram at the end of this section.



Operation of the relief

The relief is only available for gifts or sales at undervaluation:

- of qualifying assets
- by individuals to other individuals, trustees or a company (also trustees to individuals)
- if the recipient is resident in the UK at the time of the gift (except for gifts of UK land and buildings to non-UK residents – see Chapter 20), and
- a claim is made.

The relief operates as follows:

Donor	Donee
<ul style="list-style-type: none"> • Normal capital gain is calculated using market value as proceeds. • If an outright gift: <ul style="list-style-type: none"> – no tax is payable at the time of the gift by the donor as the gain is deferred. 	<ul style="list-style-type: none"> • Acquisition cost = deemed to be market value at the date of gift. • Base cost of the asset = Acquisition cost less gift holdover relief.

<ul style="list-style-type: none"> • If a sale at undervaluation: <ul style="list-style-type: none"> – a chargeable gain arises at the time of the sale if the actual sale proceeds received exceed the original cost of the asset – the balance of the gain is eligible for gift holdover relief – if the sale is part of a disposal of the entire business or qualifying shareholding, BADR may also be available. 	<ul style="list-style-type: none"> • On a subsequent disposal of the entire business or qualifying shareholding BADR may be available if the donee has owned the asset for two years.
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<ul style="list-style-type: none"> • Gift holdover relief is not automatic, it must be claimed: <ul style="list-style-type: none"> – by both the donor and the donee (exception = gift into trust just needs to be signed by the donor) – by 5 April 2028 for gifts in the tax year 2023/24.
--

Qualifying assets

The main categories of qualifying assets for gift holdover relief purposes are:

- (1) Assets used in the trade of:
 - the donor (sole trader or partnership)
 - the donor's personal company.
- (2) Unquoted shares and securities of any trading company.
- (3) Quoted shares and securities of the individual donor's personal trading company.
- (4) Any asset where there is an immediate charge to IHT (see Chapter 10).
- (5) Agricultural property where APR is available (See Chapter 11).

Note that:

- a company qualifies as an individual's personal company if the individual owns at least 5% of the voting rights
- no relief is available for business assets used in an investment business or shares in an investment company.

Interaction with business asset disposal relief

Gift holdover relief is given **before** considering business asset disposal relief (BADR).

If BADR is applicable:

- the donee may be able to make a claim for BADR on a subsequent disposal if the conditions are satisfied
- the donor may choose not to claim GR in order to
 - crystallise a gain and utilise the AEA, and/or
 - claim BADR instead so that the gain is taxed at 0% or 10% now rather than potentially at a higher rate later (i.e. if the donee will not qualify for the relief, for example by not satisfying the employment condition or two-year ownership rule).

Restrictions to gift holdover relief

Non-business use

Adjustments need to be made to the calculation of the amount of gift holdover relief available if there is an element of non-business use because the asset was:

- used partly for business purposes and partly for private use, or
- not used for business purposes for the whole of the period of ownership by the donor.

Where the asset has not been used entirely for business purposes, only the business portion of the gain is eligible for relief.

Shares in the donor's personal trading company

Gift holdover relief is also restricted if:

- shares in the donor's personal trading company (quoted or unquoted) are gifted, and
- the company holds chargeable non-business assets (for example, investments in property or shares).

The portion of the gain that is eligible for GR is calculated as follows:

$$\text{Total gain} \times \frac{\text{MV of the chargeable business assets in the company (CBA)}}{\text{MV of the all chargeable assets in the company (CA)}}$$

Note the restriction only applies if the donor holds **at least 5%** of voting rights.

Where the donor holds **less than 5%** of the voting rights:

- for unquoted shares
 - there is no restriction to the relief, full relief is available.
- for quoted shares
 - GR is not available at all.



Chargeable assets (CA)

- A chargeable asset (CA) is one that, if sold by the company, would give rise to a chargeable gain (or an allowable loss).
- Exempt assets such as cars are therefore excluded.
- Inventory, receivables, cash etc., are also excluded as they are not capital assets and therefore not chargeable.



Chargeable business assets (CBA)

- Chargeable business assets (CBAs) are defined as chargeable assets used for the purposes of a trade.
- The definition therefore specifically excludes shares, securities or other assets held for investment purposes.

These definitions can be applied to most businesses to mean the following:

	Chargeable Assets (CA)	Chargeable business assets (CBA)
Freehold/leasehold property used in trade	✓	✓
Goodwill	x	x
Cars	x	x
Plant and machinery (MV and cost £6,000 or less)	x	x
Investments (e.g. shares, investment property)	✓	x
Net current assets	x	x

Consequences of restricting gift holdover relief

Note that if the individual disposes of shares in a personal trading company:

- GR is available:
 - regardless of whether the individual works for the company
 - but may be subject to the (CBA/CA) restriction above.
- a chargeable gain will therefore arise at the time of the gift on the donor as not all of the gain can be deferred.
- the chargeable gain will be taxed on the donor at 0%, 10% or 20% depending on:
 - the availability of the donor's capital losses and AEA
 - the availability of BADR from the donor's point of view and, if not available,
 - the level of the donor's taxable income in that tax year.
- BADR is available provided:
 - the donor works for the company, and
 - it has been the donor's personal trading company
 - for the two years prior to the disposal.
- IR is available provided:
 - the donor does not work for the company
 - the donor subscribed for newly issued ordinary shares in an unlisted trading company after 17 March 2016
 - the shares have been held for a minimum of three years starting on 6 April 2016.



Test your understanding 9

Fred is a sole trader. He gave his son, Ashley, a business asset on 1 July 2023 when its market value was £75,000. Fred paid £20,000 for the asset on 1 May 2001. Ashley sells the asset for £95,000 on 1 October 2024.

- (a) **Compute the taxable gains arising on these disposals if gift holdover relief is not claimed.**
- (b) **Compute the taxable gains arising on these disposals if gift holdover relief is claimed.**
- (c) **If Ashley paid his father £53,000, what impact would this have?**



Test your understanding 10

Salma gave 30,000 ordinary shares (representing her entire 30% holding) in Cross Ltd, an unquoted trading company, to her son Omar on 16 July 2023. The shares were valued at £450,000 on that date.

Salma purchased the shares on 16 October 2012, the day she became a full-time director in the company. The shares cost Salma £200,000.

The company's issued share capital is 100,000 ordinary shares, and its net assets had the following market value on 16 July 2023:

	£
Freehold factory	1,140,000
Investments	60,000
Net current assets	370,000
	<hr/>
	1,570,000
	<hr/>

Calculate the chargeable gain for Salma and show the base cost for Omar, assuming all reliefs are claimed.

The emigration of the donee

Generally, to qualify for GR, the recipient must be resident in the UK at the time of the gift (except for gifts of UK land and buildings to non-UK residents – see Chapter 20).

If the recipient of a gift on which GR is given:

- emigrates from the UK within six years of the end of the tax year in which the gift was made
- the deferred gain at the time of the gift will crystallise and is chargeable on the donee the day before emigration.

Exception to the rule

Where the donee goes overseas to take up full time employment abroad a chargeable gain will not crystallise on departure from the UK provided the donee:

- resumes UK residence within three years, and
- has not disposed of the asset whilst abroad.



Reasoning behind emigration rules

The overseas rules covered in Chapter 20 state that if an individual is not UK resident, capital disposals are usually exempt from CGT (except for disposal of UK land and buildings).

GR is generally not available in respect of gifts to a non-UK resident person as the non-UK resident could dispose of the asset whilst abroad and avoid CGT on the donor's original gain and any increase in value since the donee received the asset.

Therefore, to qualify for GR, the recipient must generally be resident in the UK at the time of the gift.

In addition, anti-avoidance legislation has been introduced to prevent individuals getting around the rules by:

- gifting assets to a UK resident person, and
- then the donee emigrates and disposes of the asset
- to try and take advantage and avoid CGT on the donor's original gain and any increase in value since the donee received the asset.



Tax planning points

Much of tax planning for GR involves taking care to ensure that AEAs are utilised and gains are taxed at the lowest possible rates.

Rate of CGT

The outright gift of a qualifying asset results in:

- no chargeable gain arising on the donor at the time of the gift
- a higher gain arising on the donee on the subsequent disposal of the asset by the donee
- which is taxed at 0%, 10% or 20% depending on:
 - the availability of the donee's capital losses and AEA
 - the availability of BADR or IR from the donee's point of view or, if not available
 - the level of the donee's taxable income in that tax year.

However, claiming GR is optional, and if it is not claimed:

- the gain arising at the time of the gift is assessed on the donor
- which is taxed at 0%, 10% or 20% depending on:
 - the availability of the donor's capital losses and AEA,
 - the availability of BADR from the donor's point of view or, if not available,
 - the level of the donor's taxable income in that tax year.

Consequently

- the donor may **choose not to claim** GR in order to:
 - crystallise a gain and utilise capital losses and the AEA, and/or
 - claim BADR or IR
 - so that the gain is taxed at 0% or 10% now, rather than at a higher rate later.

For example, this may be advantageous if:

- the donor qualifies for BADR or IR now but the donee will not qualify for the relief on subsequent disposal of the asset (i.e. if the donee would not satisfy the employment condition and/or two-year ownership rule)
- the donor has capital losses, and/or has no other gains and therefore AEA available, and/or is a basic rate taxpayer whereas the donee is likely to be a higher rate taxpayer when the asset is disposed of.

Manipulating the chargeable gain

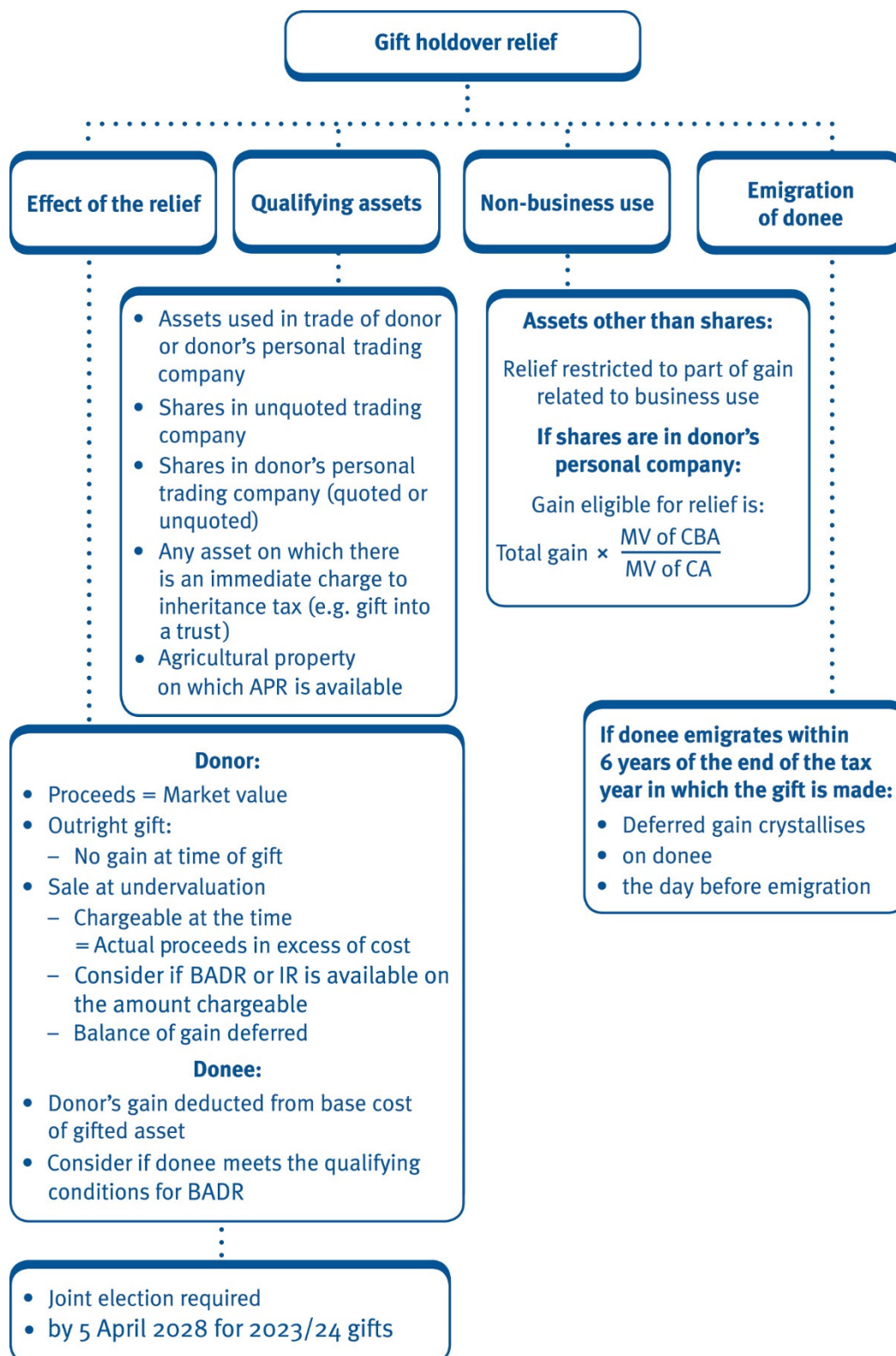
Note that if GR is claimed, all of the gain must be deferred; partial claims are not possible.

However, the individual could sell the asset at an undervaluation rather than making an outright gift to ensure that a GR claim will leave a gain to be taxed which utilises the individual's capital losses and the AEA.

Impact of IHT

Lifetime gifts have both CGT and IHT consequences. Therefore, the impact of IHT must also be considered before giving advice. The interaction of CGT and IHT is covered in Chapter 12.

Summary





7 Incorporation relief

Where an individual transfers an unincorporated business (i.e. a sole trader business or a partnership) to a company, the individual assets of the business are deemed to have been disposed of at market value to the company.

Incorporation relief is available to allow the gains arising on incorporation to be deferred until the shares in the company are disposed of.



Incorporation relief is covered in detail in Chapter 22.



8 EIS and SEIS reinvestment relief

If an individual:

- disposes of **any** chargeable asset which gives rise to a gain, and
- reinvests the proceeds in qualifying shares in an enterprise investment scheme (EIS) or seed enterprise investment scheme (SEIS)

then reinvestment relief may be claimed.

EIS reinvestment relief

If the proceeds are reinvested in EIS shares, it is possible to **defer** some, or all, of the gain arising on the asset.

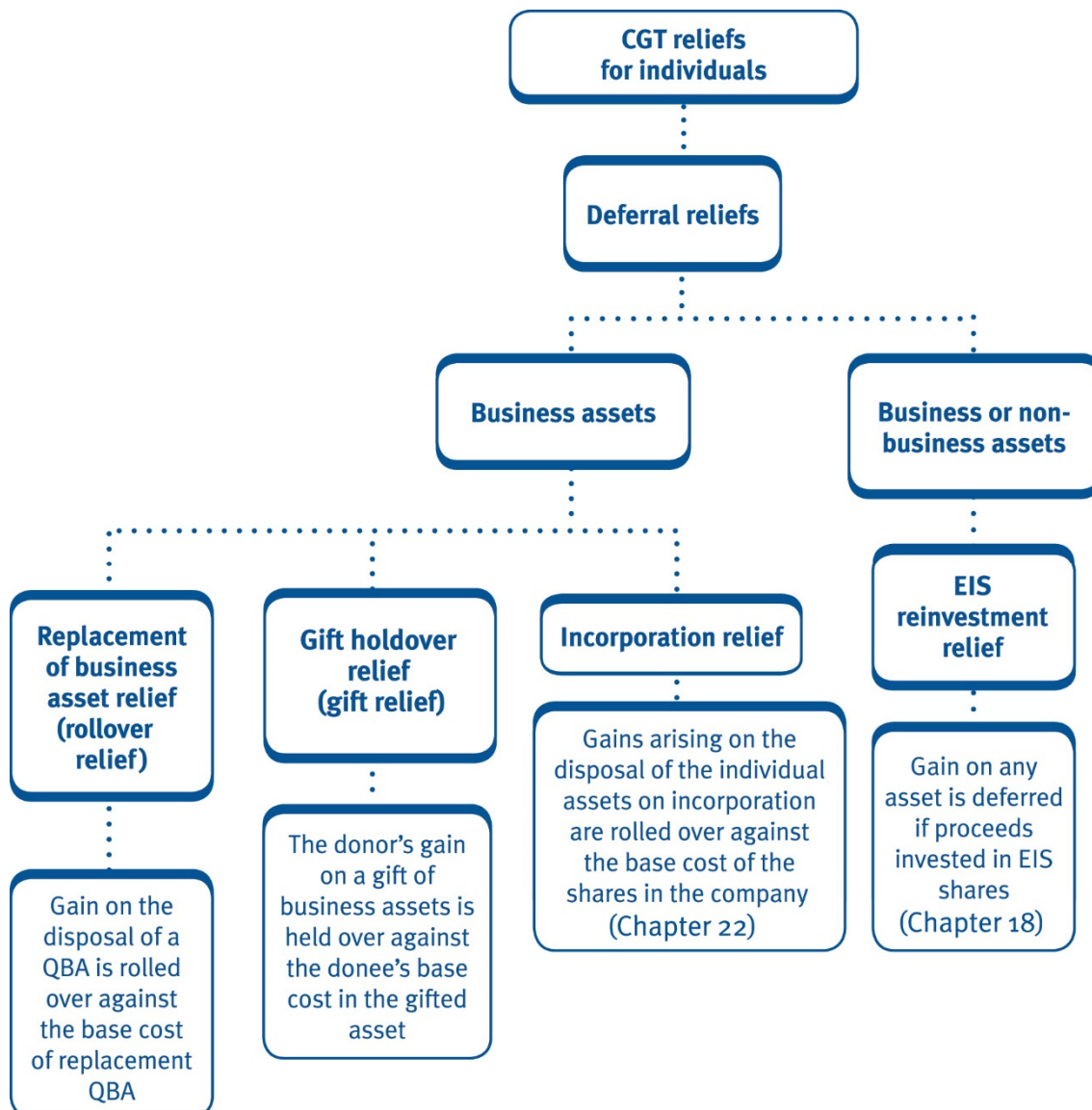
SEIS reinvestment relief

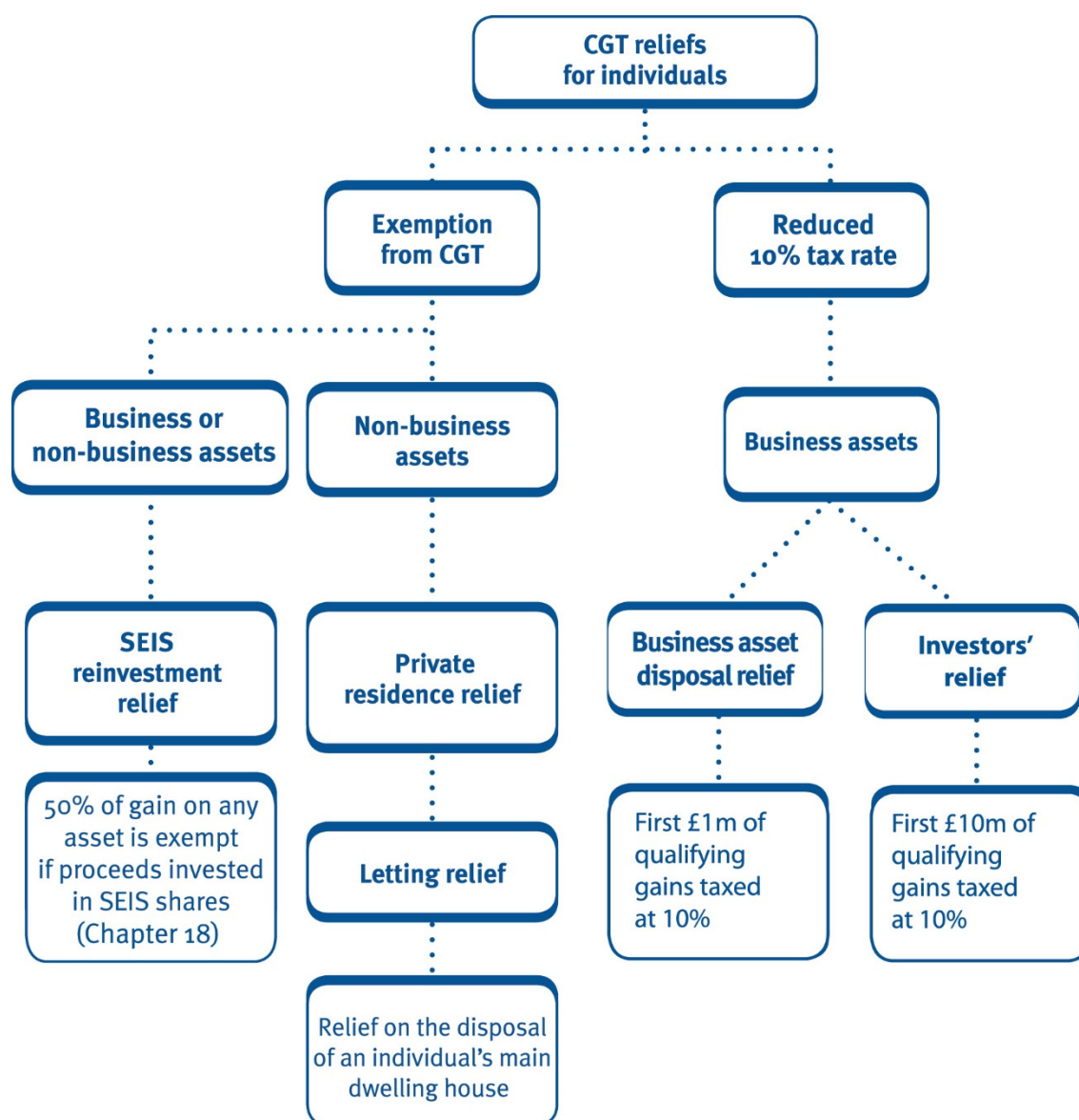
If the proceeds are reinvested in SEIS shares, up to 50% of the gain arising is **exempt** from capital gains tax (not deferred).



EIS and SEIS reinvestment relief are covered in detail in Chapter 18.

9 Chapter summary





Test your understanding answers



Test your understanding 1

Paolo

Capital gains tax

		Qualifying for BADR	Not qualifying for BADR
		£	£
2023/24			
Sale of warehouse (Note 1)			245,000
Sale of company shares		430,000	
Less: AEA (Note 2)		(0)	(6,000)
		<hr/>	<hr/>
Taxable gains		430,000	239,000
		<hr/>	<hr/>
Capital gains tax:			
Qualifying gains	(£430,000 × 10%)		43,000
Non-qualifying gains	(£239,000 × 20%) (Note 3)		47,800
			<hr/>
			90,800
			<hr/>
Due date			31.1.2025
2024/25			
	£	£	£
Sale of antique table			5,325
Sales of trading business:			
Factory	395,000		
Goodwill	130,000		
	<hr/>		
	525,000		
Qualifying for BADR (W)	(370,000)	370,000	155,000
	<hr/>	<hr/>	<hr/>
Chargeable gains		370,000	160,325
Less: AEA (Note 2)		(0)	(6,000)
		<hr/>	<hr/>
Taxable gains		370,000	154,325
		<hr/>	<hr/>

Capital gains tax:	£
Qualifying gains (£370,000 × 10%) (Note 4)	37,000
Non-qualifying gains (£154,325 × 20%) (Note 5)	30,865
	<hr/>
	67,865
	<hr/>
Due date	31.1.2026

Working: Qualifying gains in 2024/25

	£
Lifetime limit	1,000,000
Claims prior to 2023/24	(200,000)
Claim in 2023/24	(430,000)
	<hr/>
Qualifying gains in 2024/25	370,000
	<hr/>

Notes:

- (1) The disposal of the warehouse in the tax year 2023/24 is the disposal of an individual business asset used for the purposes of a continuing trade. To qualify for BADR, there must be a disposal of the whole or part of the trading business. The sale of an asset in isolation will not qualify.
- (2) The AEA is set against gains not qualifying for BADR, and any remaining AEA is then set against gains qualifying for BADR.
- (3) The gains qualifying for BADR are deemed to utilise the BR band first. Paolo's taxable income is £25,430 (£38,000 – £12,570 PA). Therefore, the BR band remaining is £12,270 (£37,700 – £25,430). However, Paolo's gains qualifying for BADR (£430,000) exceed £37,700. Therefore, there is no need to calculate the BR band remaining in this case because even if Paolo had no taxable income, and all of his BR band was available, it would be matched against these qualifying gains. Accordingly, the gains not qualifying for BADR will be taxed at 20%.
- (4) After the first £1 million of gains qualifying for BADR have been taxed at 10%, any remaining qualifying gains are taxed at the appropriate rate depending on the individual's taxable income.
- (5) There is no BR band remaining in the tax year 2024/25 as Paolo's taxable income of £42,430 (£55,000 – £12,570 PA) exceeds £37,700. Even if there were, the remaining BR band is set against gains qualifying for BADR first leaving remaining gains to be taxed at 20%.



Test your understanding 2

Nikita

		£
Chargeable gain		13,000,000
Less: AEA		(6,000)
		<hr/>
Taxable gain		12,994,000
		<hr/>
Capital gains tax:		
Qualifying gains	(£10,000,000 × 10%)	1,000,000
Non-qualifying gains	(£2,994,000 × 20%)	598,800
		<hr/>
Capital gains tax payable		1,598,800
		<hr/>

As Nikita has disposed of shares in an unlisted trading company which she subscribed for after 17 March 2016, has owned for at least three years from 6 April 2016 and she has never worked for the company she is eligible to claim investors' relief.

There is a £10 million lifetime limit so the first £10 million of her gain is taxed at 10%, with the remainder being at 20%.



Test your understanding 3

Alfonso

		£
Capital gain before reliefs		194,800
Less: PRR (W1) ($£194,800 \times 245/312$)		(152,968)
		<hr/>
		41,832
Less: Letting relief (W2)		(23,101)
		<hr/>
Chargeable gain		18,731
		<hr/>

Workings**(W1) Compute and analyse total period of ownership**

1.4.98 – 31.3.24 = 26 years (or 312 months)

	Exempt months	Chargeable months	Total months
1.4.98 – 31.3.00	24		24
1.4.00 – 30.9.05 (3 years any reason)	36	30	66
1.10.05 – 31.3.14	102		102
1.4.14 – 30.6.23 (Balance)			111
Two thirds occupied, One third let	74	37	
1.7.23 – 31.3.24 (last nine months)	9		9
	<hr/> 245 <hr/>	<hr/> 67 <hr/>	<hr/> 312 <hr/>

(W2) Letting relief

One third of the property is let between 1.4.14 and 30.6.23, i.e. 37 of the 67 months that remain in charge after PRR.

Letting relief is the lowest of:

- (1) £40,000
- (2) PRR = £152,968
- (3) Gain on letting = $(£194,800 \times 37/312) = £23,101$

An alternative working for the gain on letting is $(£41,832 \times 37/67) = £23,101$. This uses the gain after PRR and only the chargeable months. Either method would be acceptable in the exam.



Test your understanding 4

Alex

Alex owned the house for 145 months and used 1/5th of the house (one of the five rooms) for business purposes for 115 months.

The last nine months of ownership are exempt (the room had been used as part of the residence at some time).

The gain is therefore: $\text{£}70,000 \times 1/5 \times (115 - 9)/145 = \text{£}10,234$

Alternative approach:

	£	£
Capital gain before reliefs		70,000
Less: PRR		
$\text{£}70,000 \times 4/5$	56,000	
$\text{£}70,000 \times 1/5 \times (145 - (115 - 9))/145$	3,766	
	<hr/>	(59,766)
Chargeable gain		<hr/> 10,234 <hr/>



Test your understanding 5

Pascha

Capital gains tax liability – 2023/24

		Other gains £	Residential property £	Total £
	£			
Ordinary shares in Symphony Ltd				
Disposal proceeds	23,600			
Less: Cost				
(£110,400 × 5,000/40,000)				
(Note 1)	(13,800)			
		9,800		9,800
Ordinary shares in Concerto plc				
Deemed proceeds				
(10,000 × £5.14) (Note 2)	51,400			
Less: Cost (Note 1)	(14,000)			
		37,400		37,400
Antique vase (Note 5)		4,000		4,000
House				
Disposal proceeds	220,000			
Less: Cost	(114,700)			
	105,300			
Less: PRR (Note 6)	(54,348)			
			50,952	50,952
Land				
Disposal proceeds	285,000			
Less: Cost (Note 7)	(167,200)			
		117,800		117,800
Holiday cottage				
Disposal proceeds	125,000			
Less Cost (Note 8)	(101,600)			
			23,400	23,400
Total chargeable gains		169,000	74,352	243,352
Annual exempt amount			(6,000)	(6,000)
Taxable gains		169,000	68,352	237,352

Capital gains tax (Note 9)	£		£
Basic rate			
(£37,700 – £28,200)	9,500	× 10%	(other gains) 950
Higher rate			
(£169,000 – £9,500)	159,500	× 20%	(other gains) 31,900
Higher rate	68,352	× 28%	(residential) 19,139
	<u>237,352</u>		
Capital gains tax liability			<u>51,989</u>
Due date			31 January 2025
Notes:			
(1) The shares are disposed of from the share pool.			
The shares do not qualify for investors' relief as they were not subscribed for.			
BADR is not available either as Pascha's holding is < 5%.			
(2) The shares in Concerto plc are valued at the mid-price quoted on the Stock Exchange			
= (£5.10 + £5.18) × 1/2			
= £5.14)			
(3) BADR is not available on the disposal of the Concerto plc shares as Pascha's holding is < 5% (and he is not an employee).			
Gift holdover relief is not available either as Pascha's holding is < 5%.			
(4) Cars are exempt from CGT.			
(5) The antique vase is a non-wasting chattel.			
The gain is (£12,400 – £8,400) = £4,000.			
(6) The total period of ownership of the house is 93 months, of which a total of 48 months (period of occupation plus final nine months) qualify for exemption. The exemption is therefore £54,348 (£105,300 × 48/93).			
(7) The cost relating to the three hectares of land sold is £167,200 (£220,000 × £285,000/£375,000).			
(8) The transfer of the holiday cottage between Pascha and his wife is effectively ignored for CGT purposes, so the wife's original cost is used in calculating Pascha's chargeable gain.			
(9) The remaining basic rate band could be allocated instead to the residential property gains first without making any difference to the overall capital gains tax liability.			



Test your understanding 6

Katherine

Not all of the sale proceeds have been reinvested therefore some of the gain will be taxable at the time of the disposal.

May 1997

The gain taxable in May 1997 was the lower of:

• the full gain	£58,240
• the amount of the proceeds not reinvested (£100,000 – £80,000)	£20,000
The gain rolled over was therefore (£58,240 – £20,000)	£38,240

July 2023

	£	£
Proceeds on sale of building two		300,000
Less: Cost	80,000	
Gain rolled over	(38,240)	
	<hr/>	
Base cost		(41,760)
		<hr/>
Chargeable gain		258,240
		<hr/>

Note:

The chargeable gain arising in the tax year 2023/24 will be taxed at 10% or 20% depending on the level of taxable income.

BADR is not available. This is because the disposal of an individual asset used for the purposes of a continuing trade does not qualify. The trade itself is not being disposed of.



Test your understanding 7

Sophie

Disposal of office block – August 2018

	£
Sale proceeds	120,000
Less: Cost	(70,000)
	<hr/>
	50,000
Cash retained (£120,000 – £100,000) = £20,000	
Deferred gains (£50,000 – £20,000)	(30,000)
	<hr/>
Chargeable gain – 2018/19	20,000
	<hr/>

The £30,000 gain is deferred until the earliest of:

- (1) the disposal of replacement depreciating asset (November 2023)
- (2) the depreciating asset ceases to be used for the purposes of the trade (November 2023)
- (3) ten years from the date of acquisition of the replacement depreciating asset (April 2029).

Therefore, the deferred gain of £30,000 becomes chargeable in the tax year 2023/24.

Note: The chargeable gain arising in the tax year 2023/24 will be taxed at 10% or 20% depending on the level of taxable income.

BADR is not available. This is because the disposal of an individual asset used for the purposes of a continuing trade does not qualify. The trade itself is not being disposed of.

Disposal of fixed plant and machinery – November 2023

Sophie has sold the machinery for a real loss of £40,000 (£100,000 – £60,000).

However, no allowable capital loss arises as relief for the £40,000 will have been given through the capital allowances system.



Test your understanding 8

Aneesha

(a) Capital gains tax on the disposal of the factory

	£
Proceeds	160,000
Less: Cost	(40,000)
	<hr/>
Qualifying for BADR	120,000
Less: AEA	(6,000)
	<hr/>
Taxable gain	114,000
	<hr/>
Capital gains tax @ 10%	11,400
	<hr/>

(b) (i) New factory cost £172,000

All of the gain will be rolled over against the base cost of the new factory as all of the proceeds are reinvested

	£
Capital gain on factory (1)	120,000
Less: ROR	(120,000)
	<hr/>
Chargeable gain	0
	<hr/>

Base cost of new factory

Cost of new factory	172,000
Less: Gain deferred	(120,000)
	<hr/>
Base cost of new factory	52,000
	<hr/>

When Aneesha subsequently sells the replacement factory, as part of the sale of the whole of the new business, BADR will be available if the conditions are satisfied.

(ii) New factory cost £155,000

As only part of the proceeds are reinvested, the gain that cannot be rolled over will be £5,000 (£160,000 – £155,000). The rest of the gain £115,000 (£120,000 – £5,000) can be deferred.

	£
Capital gain before reliefs	120,000
Less: ROR	(115,000)
	<hr/>
Gain qualifying for BADR	5,000
Less: AEA (part wasted)	(6,000)
	<hr/>
Taxable gain	0
	<hr/>
Base cost of new factory	
Cost of new factory	155,000
Less: Gain deferred	(115,000)
	<hr/>
Base cost of new factory	40,000
	<hr/>

When Aneesha subsequently sells the replacement factory, as part of the sale of the whole of the new business, BADR will be available if the conditions are satisfied.

The remaining relief available is the full £1,000,000, as there would be no point claiming relief for the original gain of £5,000 due to the availability of the AEA.



Test your understanding 9

Fred's taxable gains

2023/24

	(a) £	(b) £	(c) £
Deemed proceeds (1 July 2023)	75,000	75,000	75,000
Less: Cost	(20,000)	(20,000)	(20,000)
	<hr/> 55,000	<hr/> 55,000	<hr/> 55,000
Less: Gift holdover relief	0	(55,000)	(22,000)
	<hr/> 55,000	<hr/> 0	<hr/> 33,000
Less: AEA	(6,000)		(6,000)
	<hr/> 49,000	<hr/> 0	<hr/> 27,000
Taxable gain			

Note: Under (c) Fred realises an actual profit of £33,000 (£53,000 – £20,000) and so this amount becomes chargeable leaving the balance to be deferred.

The taxable gains in (a) and (c) would be taxable at 10% or 20% depending on the level of taxable income. BADR is not available as this is the disposal of an individual asset not the whole or substantial part of the business.

	(a) £	(b) £	(c) £
Base cost for Ashley			
Deemed cost	75,000	75,000	75,000
Less: Gift holdover relief	(0)	(55,000)	(22,000)
	<hr/> 75,000	<hr/> 20,000	<hr/> 53,000
Base cost for future CGT disposal			

Ashley's taxable gains

2024/25

	(a) £	(b) £	(c) £
Proceeds (1 October 2024)	95,000	95,000	95,000
Less: Base cost	(75,000)	(20,000)	(53,000)
	<hr/> 20,000	<hr/> 75,000	<hr/> 42,000
Less: AEA	(6,000)	(6,000)	(6,000)
	<hr/> 14,000	<hr/> 69,000	<hr/> 36,000
Taxable gain			



Test your understanding 10

Salma

	£
Market value	450,000
Less: Cost	(200,000)
	<hr/>
Capital gain before reliefs	250,000
	<hr/>

As the gain is on shares in Salma's personal trading company, and the company holds investments, the amount eligible for gift holdover relief is restricted as follows:

$$\text{Gift holdover relief} = £250,000 \times \frac{£1,140,000}{£1,140,000 + £60,000} = £237,500$$

Note: Market values must be used in the CBA/CA fraction.

The chargeable gain at the time of the gift is therefore

	£
Capital gain (as above)	250,000
Less: Gift holdover relief	(237,500)
	<hr/>
Gain qualifying for BADR	12,500
	<hr/>

Base cost of shares to Omar

	£
Market value	450,000
Less: Gift holdover relief	(237,500)
	<hr/>
Cost of shares	212,500
	<hr/>

When Omar sells his entire holding, assuming he works for the company and owns the shares for two years, BADR will be available.

An introduction to inheritance tax

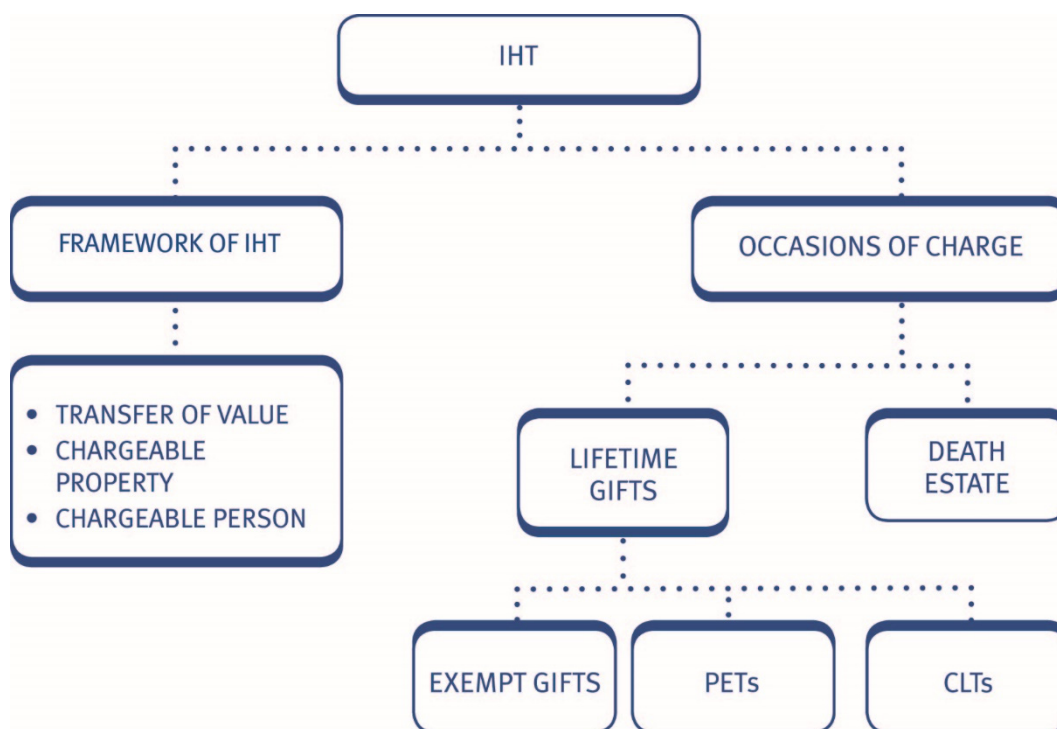
Chapter learning objectives

Upon completion of this chapter you will be able to:

- explain the concepts of domicile and deemed domicile and understand the application of these concepts to inheritance tax
- identify excluded property
- identify exempt transfers
- advise on the tax implications of chargeable lifetime transfers
- advise on the tax implications of transfers within seven years of death
- understand and apply the tapered withdrawal of the residence nil rate band where the net value of the estate exceeds £2 million
- advise on the relief for the fall in value of lifetime gifts
- advise on the use of reliefs and exemptions to minimise inheritance tax liabilities.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. This includes calculating inheritance tax, which is covered by this chapter. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This and the following two chapters deal with the way in which an individual is liable to inheritance tax (IHT).



This chapter is mainly a revision of the content covered at TX. It covers the principles that underpin IHT and considers the IHT payable calculations on lifetime gifts and on the death estate. A brief reminder of TX content is given in supplementary reading, and revision illustrations are provided to check your retention of the required TX knowledge.

Subsequent chapters cover more advanced aspects of the tax on lifetime gifts such as special valuation rules and reliefs and the detail of the computation of an individual's estate on death.

Lifetime gifts often feature in the examination as both the CGT and IHT implications of gifts can be tested. The two taxes are applicable where assets are gifted, but they work very differently. It is important to understand the distinction and interaction between the two taxes as the multi-tax aspects of capital transactions are frequently examined. Questions often require advice on how a transfer of assets could be organised more tax effectively.

The interaction of CGT and IHT is covered in Chapter 12, along with the tax implications and tax planning points to consider when planning to gift to the next generation either during your lifetime or on death in your will.

1 The charge to inheritance tax



Inheritance tax (IHT) is charged on:

- a **transfer of value**
- of **chargeable property**
- by a **chargeable person**.

A charge to IHT arises

- on the death of an individual on the estate value
- on lifetime gifts where the donor dies within seven years of date of gift
- on some lifetime gifts which are taxed at the date of the gift.



Transfer of value – diminution in value

A transfer of value is a **gift of any asset** which results in a reduction in the value of the donor's estate.

To be treated as a transfer of value the transfer must be a 'gratuitous disposition'. This basically means a gift.

A bad business deal will therefore not be liable to IHT, even though there is a fall in value of the estate, as it was not the donor's intention to give anything away.

To calculate the transfer of value for IHT purposes, **the loss to donor** principle is used (also referred to as the **diminution in value** concept).

The loss to the donor is the difference between the value of the donor's estate before and after the gift. This is the starting point for IHT calculations.

	£
Value of estate before gift	X
Less: Value of estate after gift	(X)
	—
Diminution in value/Transfer of value	X
	—

The loss to the donor is usually the **open market value** of the asset gifted.

However, in some circumstances, the transfer of value from the donor's point of view is not necessarily the same as the value of the asset received from the donee's point of view.

This is most common with unquoted shares, where a controlling shareholding has a higher value per share than a minority shareholding.

In addition, special valuation rules apply to gifts of certain assets. These rules are covered in Chapter 11.



Test your understanding 1

Shira owns 6,000 shares which represents a 60% holding in Loot Ltd. On 31 December 2023 she gifted a 20% holding in the company to her friend, Yusuf.

The values of shareholdings in Loot Ltd on 31 December 2023 have been agreed for IHT purposes as follows:

Holding	Value per share
Up to 25%	£9
26% to 50%	£15
51% to 74%	£26
75% or more	£45

Calculate the transfer of value relating to the gift of unquoted shares for IHT purposes.



Chargeable property

All property to which a person is beneficially entitled is chargeable property and is deemed to form part of the person's estate.

Therefore, a gift of any asset to which the person is beneficially entitled is a transfer of value, unless it is **excluded property**.

Excluded property is not chargeable to IHT and includes:

- property situated overseas where the owner is not UK domiciled
- reversionary interests in trust funds (see Chapter 13).



Chargeable persons

A chargeable person includes individuals and trustees of certain trusts. However, examination questions will focus on individuals.

Individuals

All individuals are potentially liable to IHT on their transfers of value.

- An individual who is domiciled in the UK is liable to IHT on transfers of worldwide assets.
- If not UK domiciled, the individual is liable on transfers of UK assets only.

Domicile for IHT is discussed in more detail in Chapter 12.

Note that spouses and partners in a registered civil partnership are chargeable to IHT separately.

2 Occasions of charge

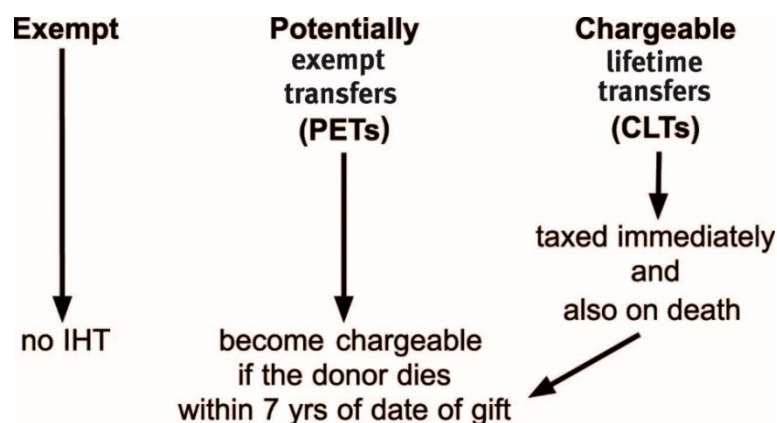
The main charge to IHT arises when individuals die as they become liable on the following:

- the value of all of their net assets in their estate at the date of death
- any lifetime gifts made in the seven years before their death, provided they are not exempt gifts.

However, IHT also arises on certain lifetime gifts at the date of the gift.

3 Lifetime gifts

There are three types of lifetime gifts by an individual for IHT purposes:



Types of lifetime gifts

Exempt transfers	Potentially exempt transfers (PETs)	Chargeable lifetime transfers (CLTs)
Definition		
A gift that is specifically deemed to be exempt from IHT (See section 4)	A gift by an individual <ul style="list-style-type: none"> to another individual into a disabled trust into certain old trusts (not examinable) 	No definition = residual category (i.e. a gift which is not exempt nor a PET) Main example: = gifts into trusts (except a charitable trust and those treated as PETs)
During lifetime		
No IHT payable	No IHT payable	IHT to pay calculated using the lifetime rates of tax
If Donor lives seven years		
No IHT payable	No IHT payable Gift becomes exempt	No further IHT payable
If Donor dies within seven years		
No IHT payable	The PET becomes chargeable on death for the first time	Possibly extra IHT payable, calculated using the death rates of tax

It is important to note that in practice, the majority of lifetime transfers made by individuals are:

- exempt transfers, or
- transfers from one individual to another (i.e. a PET).



Gifts into trusts are a complicated topic in practice, but for the ATX exam, all gifts into trusts will be treated as CLTs (other than a trust for a charity which is exempt or for a disabled person which is a PET).



Potentially exempt transfers (PETs)

PETs have derived their name from the fact that if the donor lives for more than seven years after making the gift, the transfer is exempt (i.e. free from IHT). Therefore, at the time of such transfer, it has the potential to be exempt.

However, if the donor dies within seven years of making the gift, then IHT may become chargeable on these gifts.

Note that transfers on death can never be PETs.

4 Exemptions and reliefs for IHT

The following table summarises all of the exemptions and reliefs available for IHT, some of which are covered in later chapters.

Exemptions and reliefs available against:		
Lifetime gifts only	Lifetime gifts and death estate	Death estate only
<ul style="list-style-type: none"> • Small gifts exemption <ul style="list-style-type: none"> – max £250 per recipient per tax year • Marriage/civil partnership exemption <ul style="list-style-type: none"> – £5,000 parent – £2,500 grandparent/party to marriage/civil partnership – £1,000 other • Normal expenditure out of income • Annual exemption <ul style="list-style-type: none"> – £3,000 per tax year – can c/f unused amount one year • Fall in value relief 	<ul style="list-style-type: none"> • Inter-spouse exemption • Charity exemption • Political party exemption • Agricultural property relief (APR) (see Chapter 11) • Business property relief (BPR) (see Chapter 11) 	<ul style="list-style-type: none"> • Quick succession relief (QSR) (see Chapter 11) • Double taxation relief (DTR) (see Chapter 12) • Residence nil rate band (RNRB)

5 Exemptions available for lifetime gifts only

A reminder of the detailed rules for exemptions covered at TX is given below.



Note that the rules and limits for these exemptions are **not** given in the examination, and must be learnt.



Small gifts exemption

Lifetime gifts are exempt if they are:

- an outright gift to an individual of no more than £250
- per recipient
- per tax year.

The small gift exemption does not apply if the gift is in excess of £250.

Therefore, a gift of £300 will not qualify. Similarly, if an individual makes a gift of £240 to a person followed by another gift of £100 to the same person in the same tax year, neither gift will be exempt.

However, the donor can make gifts of up to £250 to any number of recipients and they will all be exempt.



Marriage/civil partnership exemption

A lifetime transfer made 'in consideration of a marriage' (or registration of a civil partnership) is exempt up to the following maximum limits:

- £5,000 by a parent
- £2,500 by a grandparent or remoter ancestor
- £2,500 by a party to the marriage or civil partnership (e.g. from the groom to the bride)
- £1,000 by anyone else.

The exemption is conditional on the marriage taking place.

Normal expenditure out of income

IHT is levied on transfers of capital wealth.

Therefore, a lifetime transfer will be exempt if it can be shown that the gift:

- is made as part of a person's normal expenditure out of income, and
- does not affect the donor's standard of living.

To be treated as 'normal', gifts must be habitual (i.e. there is a regular pattern of giving). For example, payment of school fees for a grandchild or annual payments into a life assurance policy for the benefit of a child are usually exempted under this rule.



The annual exemption

The annual exemption (AE) is an exemption available against **lifetime** transfers and operates as follows:

- The AE:
 - exempts the **first £3,000** of lifetime transfers in any one tax year
 - is applied chronologically to the first gift in the tax year, then (if there is any left) the second gift and so on
 - must be applied to the first gift each year, even if the first gift is a PET and never becomes chargeable.
- Any unused AE:
 - may be carried forward to the next year
 - however, it can be carried forward for one year only, and
 - can only be used after the current year's AE.
- Other exemptions or reliefs, if available, are given before the AE.

Note that as the AE is used up by PETs as well as by CLTs, where more than one transfer is to be made during a tax year, CLTs should be made before PETs to ensure that the optimum use is made of the AE.



Test your understanding 2

Janet made the following lifetime gifts:

- (a) 31 August 2019, £600, to her son
- (b) 31 October 2019, £800, to a discretionary trust
- (c) 31 May 2020, £2,100, to an interest in possession (IIP) trust
- (d) 30 November 2020, £1,100, to a discretionary trust
- (e) 30 April 2021, £5,000, to her daughter.

Calculate the transfer of value after AEs for each of the gifts.

6 Exemptions available for lifetime transfers and the death estate

Inter-spouse exemption

Transfers between spouses and partners in a registered civil partnership are exempt whether they are made during the individual's lifetime or on death.



There is no maximum limit to this exemption **unless**

- the transferor is UK domiciled, and
- the transferee spouse or civil partner is non-UK domiciled.

In this case, the maximum exemption limit which is equal to the current nil rate band (NRB) (section 7) of **£325,000** can be deducted from the transfer of value.

However, an election is available whereby a non-UK domiciled individual with a UK domiciled spouse or civil partner can elect to be treated as domiciled in the UK for IHT purposes.

This may be beneficial where assets of more than £325,000 are transferred to a non-UK domiciled spouse. This is because if the election is made, there would be no limit to the exempt amount and the whole transfer would be exempt. More detail on this election is given in Chapter 12.



Political party exemption

Gifts to qualifying political parties are exempt whether they are made during the individual's lifetime or on death.

There is no maximum limit to this exemption.

A donation to a political party qualifies for exemption if, at the last general election preceding the transfer of value either of the following conditions are met:

- two members were elected to the House of Commons, or
- one member was so elected and at least 150,000 votes were cast for the party.



Charity exemption

Gifts to recognised UK charities are exempt whether they are made during the individual's lifetime or on death.

There is no maximum limit to this exemption.

In addition, there is a reduced death rate of inheritance tax for estates in which at least 10% of the taxable estate is left to charity (Chapter 11).



Gifts for the public benefit or for national purposes

- Gifts to non-profit making institutions are, with Treasury approval, exempt.
- Examples could include land and buildings of outstanding beauty, or of historic interest.
- Undertakings are required concerning the use, preservation and public access of the property.

Gifts to a number of national institutions are also exempt.

These include:

- the British Museum
- the National Gallery
- approved museums, libraries and art galleries
- the National Trust.



Test your understanding 3

Ramona made the following lifetime transfers:

- Unquoted shares worth £525,000 in the family company to her husband on 1 June 2023.
- £15,000 to her son on 6 July 2023 as a wedding present.
- £20,000 to her nephew on 27 September 2023.
- £235 to her friend for her 40th birthday on 4 November 2023.
- £270,000 into a discretionary trust on 24 December 2023.
- £90,000 to the International Red Cross, a registered charity, on 1 January 2024.
- £20,000 to the Labour Party on 14 February 2024.

Calculate the transfer of value after exemptions for each of Ramona's gifts.

7 IHT payable during an individual's lifetime on CLTs

For ATX, lifetime IHT is payable when an individual makes a gift into any trust (other than a trust for a charity which is exempt or for a disabled person which is a PET).

The procedure to calculate the lifetime IHT on a CLT

The lifetime tax should be calculated on each gift separately, in chronological order, as follows:

- (1) First consider the specific exemptions, because if the gift is completely exempt, there is no need to quantify the gift (see notes below).

- (2) Calculate the chargeable amount of each CLT and PET

	£
Value of estate before transfer	X
Less: Value of estate after transfer	(X)
	—
Transfer of value	X
Less: Business property relief and agricultural property relief	(X)
Marriage exemption	(X)
Annual exemptions	(X)
	—
Chargeable amount	X
	—

- (3) Calculate the amount of nil rate band (NRB) available after deducting gross chargeable transfers (GCTs) in the previous seven years (see below).
- (4) Calculate the tax on the excess at either 20% or 25% depending on who has agreed to pay the tax; the donor or the donee (see below).
- (5) Calculate the gross amount of the gift to carry forward for future computations.
- (6) If required by the examination question, state the due date of payment of the IHT (see below).

Notes:

- (i) If the gift is directly to, or into a trust for the benefit of:
- a charity
 - a spouse or civil partner
 - a qualifying political party
- there is no need to compute a chargeable amount as the gift will be exempt.
- (ii) There is no small gift exemption available for gifts into trusts.



The nil rate band (NRB)

All individuals are entitled to a NRB and are taxed on the value of gifts in excess of the NRB at different rates depending on who has agreed to pay the lifetime tax.

The NRB identifies the maximum value of lifetime and death gifts, which can be gifted without incurring any IHT liability.

The NRB has steadily increased each tax year in the past, although it has remained the same since 2009/10.

For lifetime calculations, the NRB applicable at **the time of the gift** should be used.



The NRB of £325,000 is provided in the tax rates and allowances in the examination. If a question requires knowledge of the NRB for an earlier tax year, when it was not £325,000, the relevant amount will be provided in the question.



The appropriate rate of tax

The appropriate rate of tax to apply to lifetime gifts depends on who has agreed to pay the tax due.

Trustees pay the tax

If the **trustees** of the trust (i.e. the donee) agree to **pay** the tax:

- the gift is referred to as a **gross gift**, and
- the appropriate rate of tax is 20%.

Donor pays the tax

If the **donor** agrees to **pay** the tax:

- the gift is referred to as a **net gift**.
- As a result of the gift, the donor's estate is being reduced by:
 - the value of the gift, **and**
 - the associated tax payable on the gift.
- Accordingly, to calculate the gross amount of the gift, it needs to be 'grossed up' to include the amount of tax that the donor has to pay.
- The appropriate rate of tax is 25% (i.e. 20/80ths of the net gift).
- The gross transfer to carry forward is the net chargeable amount of the gift plus any lifetime IHT paid by the donor. This amount remains fixed for all calculations, even if the NRB available at death differs from the amount available during the donor's lifetime.

In summary, the rate of tax on the value of CLTs in excess of the NRB is:

Payer:	Chargeable amount represents:	Appropriate rate
Trustees of the trust	Gross gift	20%
Donor	Net gift	25% (or 20/80)



Note that the tax due on a CLT is primarily the responsibility of the donor.

Therefore, where an examination question does not specify who has agreed to pay the tax, **always** assume that the **donor will pay** and that the gift is therefore a **net gift**.

The normal due date of payment of lifetime IHT

The date of payment of lifetime IHT depends on the date of the gift:

Date of CLT

6 April to 30 September

1 October to 5 April

Due date of payment

30 April in the following year

Six months after the end of the month of the CLT



Illustration 1 – IHT payable during lifetime

Charlotte makes a gift into a trust on 13 June 2023 of £366,000.

She has made no previous lifetime gifts.

Calculate the amount of lifetime IHT due on the gift into the trust and state the gross chargeable amount of the gift to carry forward for future computations, assuming:

(a) the trustees of the trust have agreed to pay any IHT due.

(b) Charlotte has agreed to pay any IHT due.

State the due date for payment of tax.

Solution

	(a) Trustees to pay IHT CLT 13.6.2023		(b) Charlotte to pay IHT CLT 13.6.2023	
		£		£
Transfer of value		366,000		366,000
Less:				
Annual exemption				
Current year	2023/24	(3,000)	2023/24	(3,000)
Previous year	2022/23 b/f	(3,000)	2022/23 b/f	(3,000)
		<hr/>		<hr/>
Chargeable amount	Gross	360,000	Net	360,000
NRB @ date of gift	2023/24	(325,000)	2023/24	(325,000)
		<hr/>		<hr/>
Taxable amount		35,000		35,000
		<hr/>		<hr/>
IHT payable	@ 20%	7,000	@ 25%	8,750
		<hr/>		<hr/>
Paid by		Trustees		Charlotte
Due date		30.4.2024		30.4.2024
Gross chargeable amount c/f		<hr/> 360,000	(£360,000 net + £8,750 tax)	<hr/> 368,750

In both parts of Illustration 1, the individual had made no previous lifetime gifts and therefore all of the NRB was available to calculate the tax. However, the NRB is available for a **'seven year cumulation period'**.



Each time a CLT is made, in order to calculate the IHT liability, it is necessary to look back seven years and calculate how much NRB is available to set against that particular gift.



The seven year cumulation period

For lifetime calculations, to calculate the NRB available at any point in time, it is necessary to take account of the total of the **gross** amounts of all other **CLTs** made within the **previous seven years**.

- These CLTs in the seven year cumulation period are deemed to have utilised the NRB first.
- There will therefore only be NRB available to match against this latest gift if the total of the CLTs in the previous seven years is less than the NRB at the time of the gift.
- Note that although PETs may use the AE during the donor's lifetime, they do not affect the NRB as they are not yet chargeable.



Test your understanding 4

During his lifetime Alan had made the following gifts:

- 30 June 2013, £183,000 to a discretionary trust
- 30 June 2019, £150,000 to his daughter
- 30 June 2020, £191,000 to a discretionary trust
- 31 December 2023, £256,000 to a discretionary trust

The trustees of the first two trusts paid the IHT liabilities. Alan paid the tax on the last gift.

Calculate the IHT arising as a result of Alan's lifetime transfers.

State who will pay the tax, the due date of payment and the gross chargeable amount of each gift to carry forward to future computations.



Test your understanding 5

During his lifetime Simon had made the following cash gifts:

- 21 April 2015, £123,000 to a discretionary trust (trustees to pay tax)
- 15 April 2020, £140,000 to his son
- 19 March 2021, £221,000 to a discretionary trust (Simon to pay tax)
- 9 May 2023, £395,000 to a discretionary trust (trustees to pay tax)

Calculate the IHT arising as a result of Simon's lifetime transfers.

Summary of lifetime calculations

Remember to:

- only calculate IHT on CLTs
- consider the IHT position for each CLT separately and in chronological order
- use the valuation rules to calculate the chargeable amount
- use the NRB applicable for the tax year of the gift
- tax is due at 20% if the trustees pay, and 25% if the donor pays.

Also remember that PETs are not chargeable at this stage, but may use the annual exemptions.

8 IHT payable on lifetime gifts as a result of death

On the death of an individual, an IHT charge could arise in relation to lifetime gifts within **seven years of death** as follows:

- PETs become chargeable for the first time.
- Additional tax may be due on a CLT.

The IHT payable on lifetime gifts as a result of death is **always** paid by the recipient of the gift:

Type of gift:	Paid by:
CLT	Trustees of the trust
PET	Donee

Calculating the death IHT on lifetime gifts

The death tax should be calculated on each gift separately, in chronological order, as follows:

- (1) Identify all gifts within seven years of death which are not exempt.
- (2) Calculate the **gross chargeable amount** of each gift and any lifetime **tax paid**.
- (3) Calculate the amount of NRB available after deducting **gross chargeable transfers** in the seven years before the gift:
 - use the NRB on the date of **death** (rather than the date of the gift)
 - transfer the **unused proportion** of a **deceased spouse or civil partner's NRB** (see later)
 - **include PETs** which have become chargeable (but not those that have become completely exempt).
- (4) Calculate the **death tax** on the excess at **40%**.
- (5) Calculate and deduct any **taper relief** available (see below).
- (6) For CLTs, deduct any **lifetime IHT paid**.
- (7) If required by the question, state who will pay the tax and the due date of payment (see below).



Further points regarding death tax calculations on lifetime gifts

Chargeable amount

- The **gross** chargeable amount of each gift is taxed on death.
- The gross amount of CLTs will have already been calculated in the lifetime IHT calculations.
- Remember to use the grossed up value of any CLTs where the tax is paid by the donor.
- The chargeable amount of a PET is calculated using the values at the time of the gift and PETs may use up the AEs, even though they only become chargeable if the donor dies within seven years.

The nil rate band

- The NRB for the year of the gift is used against the lifetime calculations.
- The NRB for the year of death is then used to calculate the death tax but it is matched against **all** chargeable gifts in the seven years prior to the date of the gift (i.e. CLTs and PETs that have become chargeable) in chronological order.

The seven year cumulation period

The seven year cumulation period for the NRB applies in a similar way as for the lifetime calculations.

However, note that:

- it is necessary to take into account the total of the **gross** amounts of **all chargeable gifts** made within the previous seven years (not just CLTs)
- therefore, to calculate the death IHT on each gift, it is necessary to look back seven years from the **date of each gift** and include the gross amount of:
 - all CLTs, **and**
 - PETs which have become chargeable due to the death of the individual.

This means that a CLT made more than seven years before death may still affect the NRB when calculating death tax on lifetime gifts.

However, ignore any PETs made more than seven years before death as they are not taxable.

The death rate of tax

The death rate of IHT is 40% on the excess over the NRB available.



Taper relief

Where IHT is chargeable on **any** lifetime transfer due to death, the amount of IHT payable on death will be reduced by taper relief:

- where more than three years have elapsed since the date of the gift
- by a percentage reduction according to the length of time between
 - the date of the gift, and
 - the date of the donor's death.

Note that:

- the relief applies to both CLTs and PETs
- for the first three years no taper relief is given

- then for each year after that, 20% relief is available, as follows:

Years before death:	Percentage reduction
More than 3 but less than 4 years	20%
More than 4 but less than 5 years	40%
More than 5 but less than 6 years	60%
More than 6 but less than 7 years	80%

For gifts made seven or more years before death there is no IHT payable on death, so taper relief is not relevant.



This table is provided in the tax rates and allowances in the examination.



Deduction of lifetime IHT paid

For CLTs, any lifetime IHT already paid can be deducted from the liability calculated on death.

However, no refund is made if the tax already paid is higher than the amount now due on death. At best, the deduction of lifetime tax paid will bring the liability on death down to £Nil.

The normal due date of payment of IHT on death

IHT as a result of death is due **six months** after the **end of the month of death**.



Illustration 2 – Death tax payable on lifetime gifts

Gino died on 30 June 2023. He made the following lifetime gifts:

- 31 July 2014, £80,000, to his son
- 30 November 2019, £110,000, to his daughter
- 30 April 2020, £235,000, to his son.

Calculate the IHT arising as a result of Gino's death on 30 June 2023. State who will pay the tax and the due date of payment.

Solution

IHT payable during lifetime

	PET 31.7.2014		PET 30.11.2019		PET 30.4.2020	
		£		£		£
Transfer of value		80,000		110,000		235,000
Less:						
Annual exemption						
Current year	2014/15	(3,000)	2019/20	(3,000)	2020/21	(3,000)
Previous year	2013/14 b/f	(3,000)	2018/19 b/f	(3,000)	2019/20 b/f	(0)
		<hr/>		<hr/>		<hr/>
Chargeable amount		74,000		104,000		232,000
		<hr/>		<hr/>		<hr/>
IHT payable (as all PETs)		0		0		0
		<hr/>		<hr/>		<hr/>
Gross chargeable amount c/f		74,000		104,000		232,000
		<hr/>		<hr/>		<hr/>

All gifts are PETs, therefore there is no lifetime tax to pay. However, the gross chargeable amount of the PETs must be established at the time of the gift.

IHT payable on death

Date of death: 30 June 2023

Seven years before: 30 June 2016

PET on 31.7.2014 is more than seven years before death – therefore no IHT payable on death.

	PET 30.11.2019		PET 30.4.2020	
	£	£	£	£
Gross chargeable amount b/f (as above)		104,000		232,000
NRB @ date of death – 2023/24	325,000		325,000	
Less:				
GCTs < 7 years before gift (30.11.2012 – 30.11.2019) (ignore 31.7.2014 PET as completely exempt)	(0)			
(30.4.2013 – 30.4.2020) (ignore 31.7.2014 PET as completely exempt, but include 30.11.2019 PET as became chargeable)			(104,000)	
NRB available		(325,000)		(221,000)
Taxable amount		0		11,000
IHT payable @ 40%		0		4,400
Less: Taper relief (30.4.2020 – 30.6.2023) (3-4 years before death) (20%)				(880)
Less: IHT paid in lifetime				(0)
IHT payable on death		0		3,520
Paid by (always the donee)				Son
Due date of payment (six months after end of month of death)				31.12.2023



Illustration 3 – Death tax payable on lifetime gifts

On 15 November 2016 Zandra made a transfer of £405,000 into a discretionary trust. She has made no other lifetime transfers. The IHT due in respect of this gift was paid by Zandra.

Zandra died on 30 September 2023.

Calculate the IHT arising on Zandra's lifetime gift, and the additional IHT arising as a result of her death.

State who will pay the tax and the due date of payment.

Solution

Lifetime IHT

15 November 2016 – CLT	£	£
Transfer of value		405,000
Less: Annual exemption		
Current year – 2016/17		(3,000)
Previous year – 2015/16 b/f		(3,000)
		<hr/>
Net chargeable amount		399,000
NRB @ date of gift – 2016/17	325,000	
Less: GCTs < 7 yrs before gift		
(15.11.2009 to 15.11.2016)	(0)	
	<hr/>	
NRB available		(325,000)
		<hr/>
Taxable amount		74,000
		<hr/>
IHT payable @ 25%		18,500
(= net gift as Zandra paying the tax)		<hr/>
Payable by		Zandra
Due date (gift in second half of tax year)		31.5.2017
		<hr/>
Gross amount to carry forward for future computations		
(£399,000 + £18,500)		417,500
		<hr/>

IHT payable on death**15 November 2016 – CLT**

	£	£
Gross chargeable amount (above)		417,500
NRB @ date of death – 2023/24	325,000	
Less: GCTs < 7 yrs before gift (15.11.2009 – 15.11.2016)	(0)	
	<hr/>	
NRB available		(325,000)
		<hr/>
Taxable amount		92,500
		<hr/>
IHT payable @ 40%		37,000
Less: Taper relief (15.11.2016 to 30.09.2023) (6 – 7 yrs) (80%)		(29,600)
		<hr/>
Chargeable (20%)		7,400
Less: IHT paid in lifetime (CLT)		(18,500)
		<hr/>
IHT payable on death		0
		<hr/>
There is no repayment of lifetime IHT.		

**Illustration 4 – IHT payable on lifetime gifts as a result of death**

Mark has made the following lifetime gifts:

- 1 September 2013, £120,000, to a discretionary trust.
- 1 May 2018, £262,000, to his son Alexander.
- 1 June 2019, £236,000, to a discretionary trust.
- 1 July 2021, £21,000, to his daughter Jayne.
- 1 August 2022, £93,000, to an interest in possession trust.

Mark had agreed to pay any IHT due on CLTs.

Mark died on 1 December 2023.

Calculate the IHT payable on the lifetime transfers during Mark's lifetime and on his death.

State who will pay the tax and the due date of payment.

Solution

IHT payable during lifetime	CLT 1.9.2013	PET 1.5.2018	CLT 1.6.2019	PET 1.7.2021	CLT 1.8.2022
Transfer of value	£ 120,000	£ 262,000	£ 236,000	£ 21,000	£ 93,000
Less: Annual exemption					
Current year	2013/14 (3,000)	2018/19 (3,000)	2019/20 (3,000)	2021/22 (3,000)	2022/23 (3,000)
Previous year	2012/13 b/f (3,000)	2017/18 b/f (3,000)	2018/19 b/f (0)	2020/21 b/f (3,000)	2021/22 b/f (0)
Chargeable amount	Net 114,000	Net 256,000	Net 233,000	Net 15,000	Net 90,000
NRB @ date of gift	£ 325,000		£		£
– 2013/14					
– 2019/20			325,000		325,000
– 2022/23					
Less:					
GCTs < 7 years before gift	(0)		(114,000)		(238,500)
(1.9.2006 – 1.9.2013)					
(1.6.2012 – 1.6.2019)					
(ignore PET)					
(1.8.2015 – 1.8.2022)					
(ignore both PETs and gift on 1.9.2013 drops out as too old)					
NRB available	(325,000)		(211,000)		(86,500)
Taxable amount	0	0	22,000	0	3,500
IHT payable	0	0	@ 25% 5,500	@ 25% 0	@ 25% 875
Paid by			Mark		Mark
Due date of payment			30.4.2020		30.4.2023
Gross chargeable amount	(£114,000 net + £Nil tax) 114,000	256,000	(£233,000 net + £5,500 tax) 238,500	15,000	(£90,000 net + £875 tax) 90,875

IHT payable on death

Date of death: 1 December 2023

7 years before: 1 December 2016

CLT on 1.9.2013 is more than 7 years before death – therefore no IHT payable on death

	PET 1.5.2018	CLT 1.6.2019	PET 1.7.2021	CLT 1.8.2022
Gross chargeable amount b/f (as above)	£ 256,000	£ 238,500	£ 15,000	£ 90,875
NRB @ date of death – 2023/24				
Less: GCTs < 7 years before gift	£ 325,000	£ 325,000	£ 325,000	£ 325,000
(1.5.2011 – 1.5.2018) (always include CLTs)	(114,000)	(370,000)		
(1.6.2012 – 1.6.2019) (£114,000 + £256,000)				
(include 1.5.2018 PET as it became chargeable)				
(1.7.2014 – 1.7.2021) (£256,000 + £238,500)			(494,500)	
((earliest CLT on 1.9.2013 drops out, include 1.5.2018 PET as it became chargeable)				(509,500)
(1.8.2015 – 1.8.2022)				
(£256,000 + £238,500 + £15,000)				
(earliest CLT on 1.9.2013 drops out, include both PETs)				
NRB available	(211,000)	(0)	(0)	(0)
Taxable amount	45,000	238,500	15,000	90,875
IHT payable @ 40%	18,000	95,400	6,000	36,350
Less: Taper relief				
(1.5.2018 – 1.12.2023) (5 – 6 years before death)	(60%) (10,800)	(40%) (38,160)	(0)	(0)
(1.6.2019 – 1.12.2023) (4 – 5 years before death)			(0)	(875)
(1.7.2021 – 1.12.2023) (< 3 years before death)				
(1.8.2022 – 1.12.2023) (< 3 years before death)	(0)	(5,500)	(0)	
Less: IHT paid in lifetime				
IHT payable on death	7,200	51,740	6,000	35,475
Paid by (always the donee)	Alexander	Trustees	Jayne	Trustees
Due date of payment	30.6.2024	30.6.2024	30.6.2024	30.6.2024



Test your understanding 6

Amal makes the following lifetime gifts:

1 May 2015	£205,000 to a discretionary trust, Amal is to pay the IHT.
30 June 2016	£60,000 to her niece on the occasion of her 21st birthday.
11 June 2017	£134,000 to her nephew on the occasion of his marriage.
11 November 2021	£136,000 to a discretionary trust, the trustees are to pay the IHT.

- Calculate the IHT liabilities arising as a result of the lifetime gifts.**
- If Amal dies on 14 February 2024, calculate the additional IHT on the lifetime gifts as a result of Amal's death.**
- Calculate the nil rate band left to set against the death estate.**



9 Fall in value (FIV) relief

The chargeable amount of a lifetime gift (CLT or PET) is calculated and fixed **at the time of the gift**.

If the gift becomes chargeable on the death of the donor:

- any **increase** in value between the date of the gift and the date of the donor's death is **ignored**
- if the asset **decreases** in value between the date of the gift and the date of the donor's death, **relief is available** to reduce the chargeable amount of this gift on death.

Conditions

To qualify for this relief, the asset must:

- either **still be owned** by the donee at the date of the donor's death, or
- it was **sold in an arm's length transaction** before the donor died.

Note that this relief is not available in respect of any property which is expected to fall in value over time, for example:

- plant and machinery
- wasting chattels (i.e. tangible movable property with a predictable useful life of less than 50 years).

Operation of the relief

The relief operates by **reducing the chargeable amount by the fall in value**, calculated from **the donee's point of view**.

The fall in value is the difference between:

- the value of the asset at the date of the gift
- the value of the asset at
 - the date of the donor's death, or
 - the date of the sale (if earlier).

Note that this relief

- applies to both PETs and CLTs
- only affects the calculation of the IHT on that one gift
- has no effect on lifetime IHT already paid
- has no effect on the IHT payable on any subsequent gifts or the death estate.

Therefore, the **original gross chargeable amount** is accumulated and carried forward to calculate the NRB on subsequent events.



Test your understanding 7

Tim died on 30 June 2023.

On 30 April 2020 Tim had made a gift of 100,000 shares (a 1% holding) in ABC plc, a quoted company, into a discretionary trust. Tim paid the IHT arising on the gift. Tim had made no other lifetime gifts.

ABC plc's shares were worth £3.65 each on 30 April 2020, and £3.35 each when Tim died on 30 June 2023.

- (a) **Calculate the IHT liability arising in respect of Tim's lifetime transfer on 30 April 2020, stating when it is due for payment.**
- (b) **Calculate the gross chargeable amount to carry forward for the IHT on the death estate computation.**

10 IHT payable on the death estate

On the death of an individual, an IHT charge arises on the value of the individual's estate at the date of death.

The detailed computation of a death estate is covered in Chapter 11. This section explains how the IHT charge is calculated once the estate value has been established.

The procedure to calculate the IHT on the death estate

The procedure to calculate the IHT on the death estate is as follows.

- (1) Deal with the IHT on lifetime gifts within seven years of the date of death first **before** dealing with the estate computation.
- (2) Calculate the gross chargeable estate value (Chapter 11).
- (3) Calculate the amount of residence nil rate band (RNRB) available if applicable (see below).
- (4) Calculate the amount of NRB available after deducting GCTs in the previous seven years (i.e. CLTs and PETs).
- (5) Calculate the tax on the excess at 40% or 36% if at least 10% of the baseline amount is left to charity (see Chapter 11).
- (6) Deduct quick succession relief (see Chapter 11) and double taxation relief (see Chapter 12), if applicable.
- (7) If required by the question, state who will pay the tax (see Chapter 11) and the due date of payment (see below).



Further points regarding IHT payable on the death estate

Residence nil rate band (RNRB)

The RNRB applies when a dwelling house, which has been the deceased's residence, is inherited by direct descendants.

The nil rate band

The NRB available to an individual on death of £325,000 is first used to calculate the death tax on lifetime gifts, then the estate after the lifetime gifts have been dealt with.

The seven year cumulation period

The seven year cumulation period applies in a similar way to the death calculations on lifetime gifts as follows:

- it is necessary to take into account the total of the gross amounts of all **chargeable gifts** made within the **previous seven years**
- therefore, look back seven years from the date of death and accumulate the gross amounts of:
 - **all CLTs, and**
 - **all PETs** (because all PETs within seven years of death will have become chargeable on death).

The normal due date of payment of IHT on death

IHT as a result of death is due on the earlier of:

- **six months** after the end of the month of death, or
- on delivery of the account of the estate assets to HMRC.

Note that who pays the tax on the estate value depends on the composition of the estate. This is covered in detail in Chapter 11.



Illustration 5 – IHT payable on the death estate

Shristi died on 15 June 2023 leaving a gross chargeable estate valued at £427,000 all of which was bequeathed to her brother.

- Calculate the IHT liability arising on Shristi's estate assuming she made no lifetime transfers**
- What if Shristi had gross chargeable transfers of £147,000 in the seven years prior to her death?**

Solution

- No lifetime transfers**

	£	£
Gross chargeable estate value		427,000
NRB @ date of death – 2023/24	325,000	
Less: GCTs < 7 yrs before death (15.6.2016 – 15.6.2023)	(0)	
	<hr/>	<hr/> (325,000)
Taxable amount		102,000
		<hr/>
IHT payable @ 40%		40,800
		<hr/>

- Lifetime transfers = £147,000**

	£	£
Gross chargeable estate value		427,000
NRB @ date of death – 2023/24	325,000	
Less: GCTs < 7 yrs before death (15.6.2016 – 15.6.2023)	(147,000)	
	<hr/>	<hr/> (178,000)
Taxable amount		249,000
		<hr/>
IHT payable @ 40%		99,600
		<hr/>



Test your understanding 8

Thomas died on 23 April 2023 leaving a gross chargeable estate valued at £627,560 which was bequeathed to his girlfriend.

Thomas had made the following lifetime gifts:

- 1 June 2014, £180,000, to a discretionary trust
- 16 March 2019, £228,000, to his cousin.

Calculate the IHT liability arising on Thomas's estate and state the due date of payment.

Residence nil rate band (RNRB)

An additional nil rate band, up to a maximum of £175,000 in 2023/24, is available when calculating the IHT on the death estate where a main residence is inherited on death by the deceased's direct descendants. This is known as the residence nil rate band (RNRB).

The RNRB applies when:

- calculating the tax on the **death estate**, and
- the date of death is **on or after 6 April 2017**, and
- the chargeable death estate includes a **main residence** that is inherited by the deceased's **direct descendants** (e.g. child/grandchild).



Further points regarding RNRB

The RNRB applies when a dwelling house, which has been the deceased's residence, is inherited by direct descendants. Note that the deceased must only have lived in the residential property at some time. It does not have to have been the deceased's main residence or be lived in by the deceased at the date of death. Also there are no minimum occupancy requirements.

For the purposes of the examination a question will make it clear whether the RNRB is available. The examination team has stated that if there is no reference to a main residence within the question then it should be assumed that the RNRB is not available.

Unlike the normal NRB, the RNRB is not available when calculating the additional tax due on lifetime gifts as a result of death. So, if a house is given to a child during lifetime, the RNRB is not available when calculating any death tax due as a result of the PET becoming chargeable. The only exception to this would be if the house was treated as a gift with reservation (see Chapter 12) and included in the death estate, in which case the RNRB would be available against the estate.

Only one property can qualify.

If the deceased owned more than one residential property, the personal representatives can nominate which property will be entitled to the RNRB. However, this aspect of the RNRB is not examinable.

Buy-to-let properties are not eligible for the RNRB.

The available RNRB is the **lower of:**

- **£175,000** (subject to tapering for high value estates – see below) and
- the **value (net of repayment mortgages) of the residential property.**



The RNRB of £175,000 is included in the tax rates and allowances provided to you in the examination.

In calculating the tax on the death estate the RNRB is applied before the normal NRB.

There are additional complex rules that apply when an individual has moved into a smaller house, or sold or given away the main residence before death. These rules are not examinable.



Test your understanding 9

Ashley died on 1 December 2023, leaving a chargeable estate of £750,000 including a residential property valued at £400,000. Ashley had lived in the property for the ten years prior to her death and at the date of death had a repayment mortgage outstanding on the property of £80,000.

Ashley left the residential property to her daughter Hannah and the residue of her estate to her partner, Ted. Ashley and Ted have never married and Ashley made no lifetime gifts.

Calculate the inheritance tax due on Ashley's death estate.



Tapered withdrawal of the RNRB

The RNRB will be withdrawn:

- from estates with a net value (**before** deducting APR, BPR and exemptions) exceeding £2 million
- at a rate of £1 for every £2 exceeding the threshold.

The RNRB will therefore be reduced to £Nil when the net estate is £2,350,000 or more (£2 million + (£175,000 × 2)).



Test your understanding 10

On 1 May 2023 Ilgar died, leaving the following assets and liabilities:

	£
House (net of a repayment mortgage of £100,000)	600,000
Bank account	700,000
Quoted shares	750,000
Credit card bills	(3,000)
	<hr/>
Value of estate	2,047,000
	<hr/>

Ilgar left the house, which they had lived in for many years, to their daughter, the shares to their husband and the residue of their estate to their son.

Calculate the available RNRB and the IHT liability on the death estate, assuming Ilgar had not made any lifetime gifts.

Transfer of unused nil rate bands

Any amount of NRB or RNRB that has not been utilised at the time of a person's death can be transferred to the surviving spouse or civil partner.

As a result, each spouse or civil partner can leave his, her or their whole estate to the surviving spouse or civil partner and the couple will not lose the benefit of the NRB and/or RNRB.

- The surviving spouse or civil partner will have the benefit of
 - his, her or their own NRB/RNRB, **and**
 - any unused proportion of the spouse's or civil partner's NRB/RNRB.
- The amount of the NRB/RNRB that can be claimed is based on the **proportion** that was **unused by the first spouse** to die.
- The unused proportion is applied to the **NRB/RNRB available on the second spouse's death**.
- The executors of the surviving spouse or civil partner must claim the transferred NRB/RNRB by submitting the IHT return by the later of:
 - two years from the second death, or
 - three months from the executor starting to act.
- The increased amount of NRB can be used against any lifetime gifts taxable as a result of the donor's death and the death estate.
- The increased amount of RNRB can only be used against residential property left in the death estate to direct descendants.

- The transfer of the RNRB is available even when the first spouse or civil partner died before 6 April 2017 (i.e. the date that the RNRB was introduced), provided the surviving spouse died on or after 6 April 2017. In this case, the unused proportion of the RNRB will always be 100% as the first spouse could not have used the RNRB on death (as this was before the RNRB was introduced).



Test your understanding 11

Darya was widowed on the death of her husband Denys on 21 June 2007.

Denys had a chargeable estate valued at £800,000, and this was left entirely to Darya. Included in the estate was Denys's 50% share of the family home.

Darya died on 23 May 2023 leaving an estate valued at £1,050,000 to her two children. Included in her estate was the family home valued at £475,000.

Darya has made no lifetime transfers.

The nil rate band for 2007/08 was £300,000.

Calculate the IHT liability due as a result of Darya's death assuming:

- Denys made no lifetime transfers**
- Denys gave £182,700 to his son on 16 March 2007.**

Tax planning

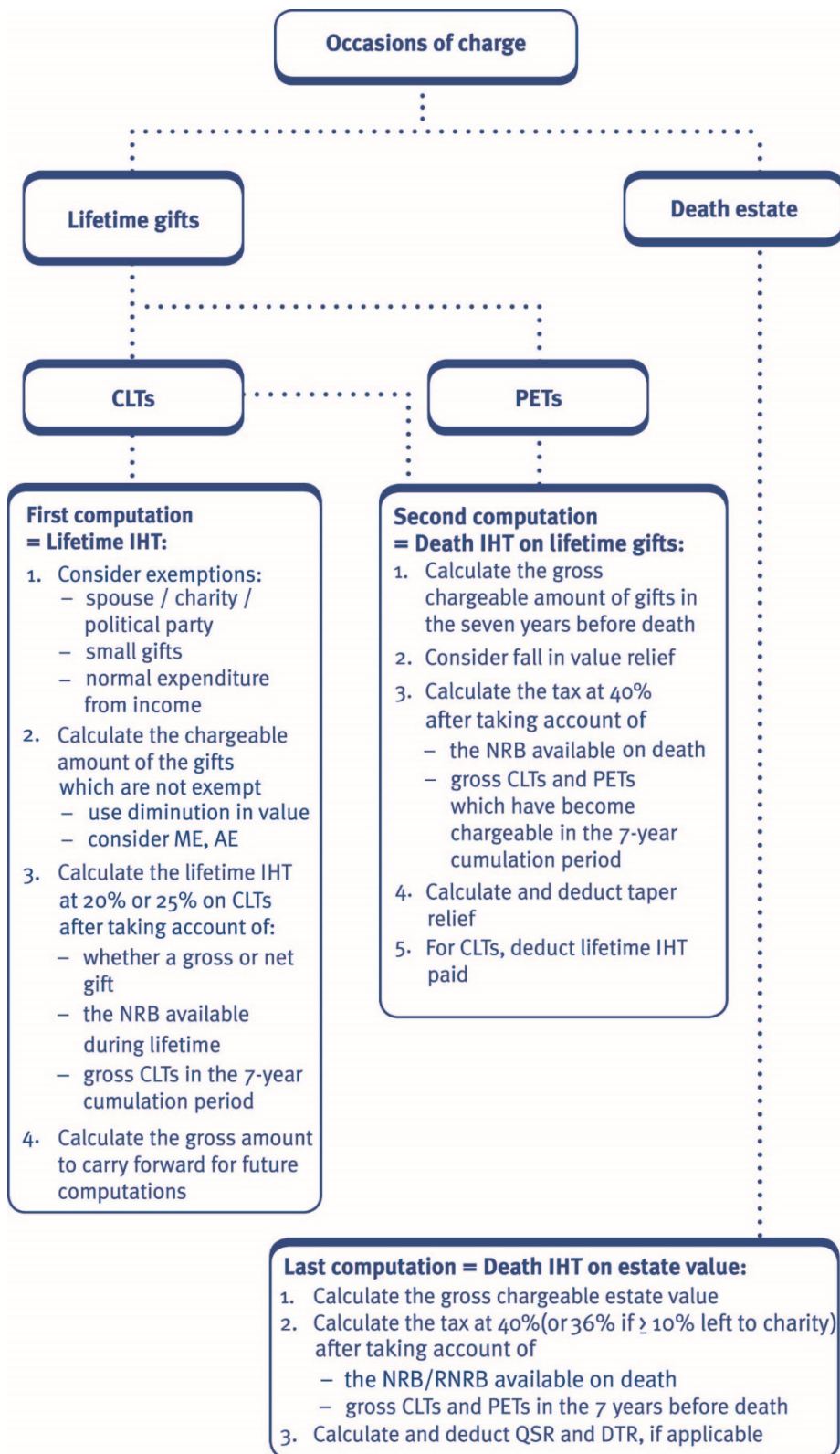
Qualifying residential property should be left to direct descendants in priority to other assets.

Residential property left to anyone other than direct descendants is not eligible for the RNRB, resulting in more IHT being paid on the death estate.

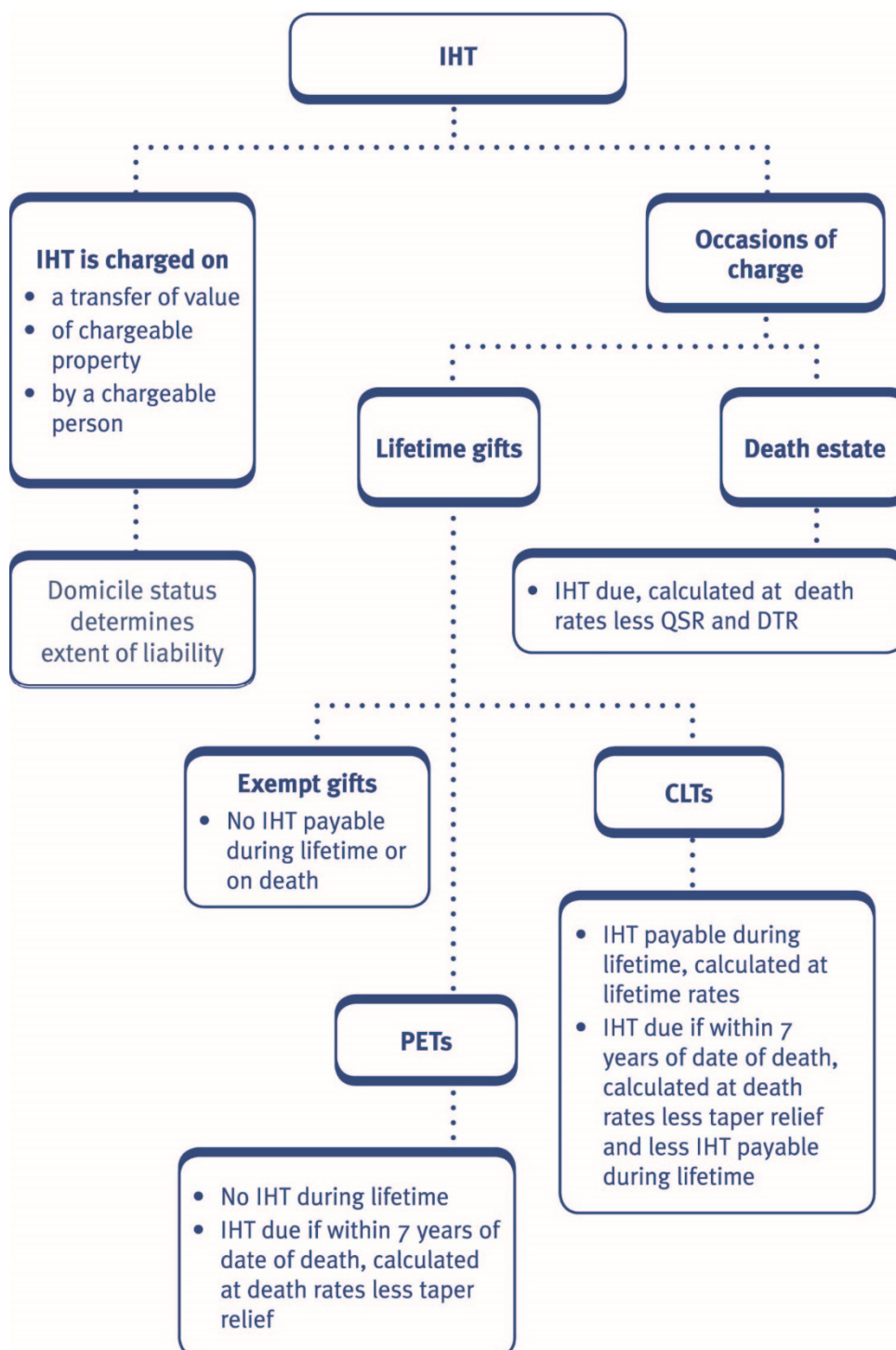
Leaving residential property to direct descendants could potentially save IHT of £70,000 (40% tax on £175,000 of RNRB), or as much as £140,000 ($2 \times £70,000$) where an unused RNRB from a deceased spouse or civil partner is also available.

Where an individual has already died and has not left the main residence to direct descendants, a deed of variation (see Chapter 12) could be used to vary the will and leave the residential property to direct descendants instead.

Summary



11 Chapter summary



Test your understanding answers



Test your understanding 1

Shira

	£
Value of estate before transfer (6,000 × £26)	156,000
Less: Value of estate after transfer (4,000 × £15)	(60,000)
	<hr/>
Transfer of value	96,000
	<hr/>

Note that a lifetime gift will have both IHT and CGT consequences.

The diminution in value concept is very important but unique to IHT.

The value of the asset gifted, a 20% interest in these shares = (2,000 × £9) = £18,000

This value:

- is not relevant for IHT purposes; it is the diminution in the value of the estate from the donor's point of view which is important, but
- is important for CGT purposes; the market value of the asset gifted is always the consideration used as the starting point of a chargeable gain computation.



Test your understanding 2

Janet

	PET 31.8.19	CLT 31.10.19	CLT 31.5.20	CLT 30.11.20	PET 30.4.21
Tax year of gift	2019/20	2019/20	2020/21	2020/21	2021/22
	£	£	£	£	£
Transfer of value	600	800	2,100	1,100	5,000
Less: Annual exemption					
2019/20	(600)	(800)			
2018/19 b/f (£3,000 avail)	(0)	(0)			
(all lost as not used and can only c/f for one year)					
2020/21			(2,100)	(900)	
2019/20 b/f (£1,600 avail)			(0)	(200)	
(remaining £1,400 lost as not used)					
2021/22					(3,000)
2020/21 b/f (none available – already used)					(0)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Chargeable amount	0	0	0	0	2,000
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>



Test your understanding 3

Ramona

Exempt gifts

- 1.6.2023 Gift to husband = exempt inter-spouse transfer
- 4.11.2023 Gift to friend = small gift exemption applies as the gift is less than £250
- 1.1.2024 Gift to International Red Cross = exempt gift to charity
- 14.2.2024 Gift to Labour party = exempt gift to political party

Remaining gifts – chargeable amount

	PET 6.7.2023	PET 27.9.2023	CLT 24.12.2023
Tax year of gift	2023/24	2023/24	2023/24
	£	£	£
Transfer of value	15,000	20,000	270,000
Less: Marriage exemption	(5,000)		
Less: Annual exemption			
2023/24	(3,000)	(0)	(0)
2022/23 b/f	(3,000)	(0)	(0)
Chargeable amount	<u>4,000</u>	<u>20,000</u>	<u>270,000</u>

The gifts to the son and nephew are PETs – therefore no tax is payable unless Ramona dies within seven years.

The gift into trust is a CLT and is chargeable during Ramona's lifetime. However, as she has no chargeable gifts in the preceding seven years, there will be no IHT to pay as the gift is covered by the NRB of £325,000 (see later).



Test your understanding 4

Alan	CLT 30.6.2013	PET 30.6.2019	CLT 30.6.2020	CLT 31.12.2023
Transfer of value	£ 183,000	£ 150,000	£ 191,000	£ 256,000
Less: Annual exemption				
Current year	2013/14 (3,000)	2019/20 (3,000)	2020/21 (3,000)	2023/24 (3,000)
Previous year	2012/13 b/f (3,000)	2018/19 b/f (3,000)	2019/20 b/f (0)	2022/23 b/f (3,000)
Chargeable amount	Gross 177,000	144,000	Gross 188,000	Net 250,000
NRB @ date of gift	£ 325,000		£ 325,000	£ 325,000
– 2013/14				
– 2020/21				
– 2023/24				
Less: GCTs < 7 years before gift	(0)		(177,000)	(188,000)
(30.6.2006 – 30.6.2013)				
(30.6.2013 – 30.6.2020)				
(ignore PET)				
(31.12.2016 – 31.12.2023)				
(ignore PET and CLT on 30.6.2013 drops out as too old)				
NRB available	(325,000)		(148,000)	(137,000)
Taxable amount	0	0	40,000	113,000
IHT payable	0	0	@ 20% 8,000	@ 25% 28,250
Paid by			Trustees	Alan
Due date of payment			30.4.2021	30.6.2024
Gross chargeable amount c/f	177,000	144,000	188,000	(£250,000 net + £28,250 tax) 278,250



Test your understanding 5

Simon	CLT 21.4.2015	PET 15.4.2020	CLT 19.3.2021	CLT 9.5.2023
Transfer of value	£ 123,000	£ 140,000	£ 221,000	£ 395,000
Less: Annual exemption				
Current year	2015/16 (3,000)	2020/21 (3,000)	2020/21 (0)	2023/24 (3,000)
Previous year	2014/15 b/f (3,000)	2019/20 b/f (3,000)	2019/20 b/f (0)	2022/23 b/f (3,000)
Chargeable amount	Gross 117,000	134,000	Net 221,000	Gross 389,000
NRB @ date of gift	£		£	£
– 2015/16	325,000			
– 2020/21			325,000	
– 2023/24				325,000
Less: GCTs < 7 years before gift	(0)		(117,000)	(224,250)
(21.4.2008 – 21.4.2015)				
(19.3.2014 – 19.3.2021)				
(ignore PET)				
(9.5.2016 – 9.5.2023)				
(ignore PET and gift on				
21.4.2015 drops out as too old)				
NRB available	(325,000)		(208,000)	(100,750)
Taxable amount	0	0	13,000	288,250
IHT payable	0	0	@ 25% 3,250	@ 20% 57,650
Paid by			Simon	Trustees
Due date of payment			30.9.2021	30.4.2024
Gross chargeable amount	117,000	134,000	(£221,000 net + £3,250 tax) 224,250	389,000



Test your understanding 6

Amal		CLT 1.5.2015	PET 30.6.2016	PET 11.6.2017	CLT 11.11.2021
(a)	IHT payable during lifetime				
	Transfer of value				
	Less: Marriage exemption				
	Less: Annual exemption				
	Current year	2015/16	2016/17	2017/18	2021/22
	Previous year	2014/15 b/f	2015/16 b/f	2016/17 b/f	2020/21 b/f
	Chargeable amount	Net			Gross
		£ 199,000	£ 57,000	£ 130,000	£ 130,000
	NRB @ date of gift				
	– 2015/16	£ 325,000			£
	– 2021/22				325,000
	Less: GCTs < 7 years before gift				
	(1.5.2008 – 1.5.2015)	(0)			(199,000)
	(11.11.2014 – 11.11.2021)				
	(ignore PETs)				
	NRB available	(325,000)			(126,000)
	Taxable amount	0	0	0	4,000
	IHT payable	0	0	0	800
	Paid by				Trustees
	Due date of payment				31.5.2022
	Gross chargeable amount	(£199,000 net + £Nil tax)	£57,000	£130,000	£130,000

(b) IHT payable on death

Date of death: 14 February 2024
 7 years before: 14 February 2017

CLT on 1.5.2015 and PET on 30.6.2016 are more than 7 years before death – therefore no IHT payable on death

	PET 11.6.2017	CLT 11.11.2021
	£	£
Gross chargeable amount b/f (as above)	130,000	130,000
NRB @ date of death – 2023/24		
Less: GCTs < 7 years before gift	£ 325,000	£ 325,000
(11.6.2010 – 11.6.2017)	(199,000)	
(exclude PET on 30.6.2016 as it became completely exempt)		
(11.11.2014 – 11.11.2021) (£199,000 + £130,000)		(329,000)
(exclude PET on 30.6.2016 as it became completely exempt, but include 11.6.2017 PET as it became chargeable)		
NRB available	(126,000)	(0)
Taxable amount	4,000	130,000
IHT payable @ 40%	1,600	52,000
Less: Taper relief		
(11.6.2017 – 14.2.2024) (6 – 7 years before death)	(1,280)	(0)
(11.11.2021 – 14.2.2024) (< 3 years before death)	(0)	(800)
Less: IHT paid in lifetime		
IHT payable on death	320	51,200
Paid by (always the donee)	Nephew	Trustees
Due date of payment	31.8.2024	31.8.2024

(c) Nil rate band left to set against the death estate	
	£
NRB @ date of death – 2023/24	325,000
Less: GCTs < 7 yrs before death (14.2.2017 to 14.2.2024) (£130,000 + £130,000) (first two gifts = too old, include PET on 11.6.2017 as it became chargeable on death)	(260,000)
	<hr/>
NRB available against death estate	65,000
	<hr/>



Test your understanding 7

Tim

(a) IHT liability arising on the lifetime gift

Lifetime IHT

30 April 2020 – CLT

	£	£
Transfer of value (100,000 × £3.65)		365,000

Less: Annual exemption

Current year – 2020/21	(3,000)
------------------------	---------

Previous year – 2019/20 b/f	(3,000)
-----------------------------	---------

Net chargeable amount (Tim agreed to pay)	359,000
---	---------

NRB @ date of gift – 2020/21	325,000
------------------------------	---------

Less: GCTs in 7 years before gift (30.4.2013 to 30.4.2020)	(0)
---	-----

NRB available	(325,000)
---------------	-----------

Taxable amount	34,000
----------------	--------

IHT payable @ 25%	8,500
-------------------	-------

Due date (gift in first half of tax year)	30.4.2021
---	-----------

GCT c/f (£359,000 + £8,500)	367,500
-----------------------------	---------

IHT payable on death

30 April 2020 – CLT	£	£
GCT b/f (above)		367,500
Less: Fall in value relief		
Value at gift ($100,000 \times £3.65$)	365,000	
Value at Tim's death		
($100,000 \times £3.35$)	(335,000)	
		<hr/>
Alternative calculation		
($100,000 \times (£3.65 - £3.35)$)		(30,000)
		<hr/>
Revised chargeable amount on death		337,500
NRB @ date of death – 2023/24	325,000	
Less: GCT < 7 years before gift		
(30.4.2013 to 30.4.2020)	(0)	
		<hr/>
NRB available		(325,000)
		<hr/>
Taxable amount		12,500
		<hr/>
IHT payable @ 40%		5,000
Less: Taper relief		
(30.4.2020 – 30.6.2023)		
(3 – 4 years before death) (20%)		(1,000)
Less: IHT paid in lifetime (CLT)		(8,500)
		<hr/>
IHT payable on death		0
		<hr/>

There is no repayment of lifetime IHT paid

(b) **Gross chargeable amount to carry forward to the death estate computation**

Note that Tim's cumulative total to carry forward is the original gross chargeable amount per the lifetime IHT calculation.

Gross cumulative total to carry forward = £367,500



Test your understanding 8

Thomas

IHT payable during lifetime

	CLT 1.6.2014		PET 16.3.2019	
		£		£
Transfer of value		180,000		228,000
Less: Annual exemption				
Current year	2014/15	(3,000)	2018/19	(3,000)
Previous year	2013/14 b/f	(3,000)	2017/18 b/f	(3,000)
		<hr/>		<hr/>
Chargeable amount	Net	174,000		222,000
		<hr/>		<hr/>
		£		
NRB @ date of gift – 2014/15		325,000		
Less:		(0)		
GCTs < 7 years before gift (1.6.2007 – 1.6.2014)				
		<hr/>		
NRB available		(325,000)		
		<hr/>		
Taxable amount		0		0
		<hr/>		<hr/>
IHT payable		0		0
		<hr/>		<hr/>
Gross chargeable amount c/f		174,000		222,000
		<hr/>		<hr/>

IHT payable on death

Date of death: 23 April 2023

Seven years before: 23 April 2016

CLT on 1.6.2014 is more than seven years before death – therefore no IHT payable on death.

	PET 16.3.2019		Estate value 23.4.2023	
	£	£	£	£
Gross chargeable amount		222,000		627,560
			325,000	
NRB @ date of death 2023/24	325,000			
Less:				
GCTs < 7 years before gift (16.3.2012 – 16.3.2019)	(174,000)			
Less:				
GCTs < 7 years before death (23.4.2016 – 23.4.2023) (earliest CLT on 1.6.2014 drops out, include PET on 16.3.2019 as it became chargeable)			(222,000)	
NRB available		(151,000)		(103,000)
Taxable amount		71,000		524,560
IHT payable @ 40%		28,400		209,824
Less: Taper relief (16.3.2019 – 23.4.2023) (4 – 5 years before death)	(40%)	(11,360)		
Less: IHT paid in lifetime		(0)		
IHT payable on death		17,040		
Paid by		Cousin		Executors
Due date of payment		31.10.2023		31.10.2023



Test your understanding 9

Ashley

	£
Gross chargeable estate	750,000
Less: Residence nil rate band (W)	(175,000)
Less: Nil rate band	(325,000)
	<hr/>
Taxable estate	250,000
	<hr/>
IHT × 40%	100,000
	<hr/>

Working: Residence nil rate band (RNRB)

The available RNRB is the lower of:

- RNRB threshold £175,000
 - Net value of the property (£400,000 – £80,000) £320,000
- i.e. £175,000



Test your understanding 10

Ilgar

Ilgar is entitled to the RNRB as they died after 6 April 2017 and left a residential home to a direct descendant (i.e. their daughter).

The value of Ilgar's estate (net of liabilities) exceeds £2 million. The maximum RNRB is therefore tapered as follows:

	£
Maximum RNRB	175,000
Less: 50% × (£2,047,000 – £2,000,000)	(23,500)
	<hr/>
Reduced maximum RNRB	151,500
	<hr/>

The available RNRB is therefore the lower of:

- Reduced maximum RNRB £151,500
 - Net value of the property £600,000
- i.e. £151,500

	£
Estate value	2,047,000
Less: Exempt legacy to husband (shares)	(750,000)
	<hr/>
Gross chargeable estate	1,297,000
Less: RNRB	(151,500)
Less: NRB at death (no lifetime transfers)	(325,000)
	<hr/>
Taxable amount	820,500
	<hr/>
IHT liability (£820,500 × 40%)	328,200
	<hr/>



Test your understanding 11

(a) Denys made no lifetime transfers

On Denys' death:

- no lifetime gifts, so all NRB available for his death estate
- the transfer of his estate to Darya is an exempt legacy
- so, no IHT was due on his estate, and
- therefore none of his NRB was utilised (i.e. 100% unutilised).

Darya – Death estate

	£
Gross chargeable estate	1,050,000
Less: RNRB at date of Darya's death	(175,000)
Less: RNRB transferred from Denys (£175,000 × 100%)	(175,000)
Less: NRB at date of Darya's death	(325,000)
Less: NRB transferred from Denys (Note) (£325,000 × 100%)	(325,000)
	<hr/>
Taxable amount	50,000
	<hr/>
IHT payable on death (£50,000 × 40%)	20,000
	<hr/>

This IHT is paid by the executors, but borne by Darya's children.

Note:

- Although the NRB available on Denys's death was only £300,000, the amount unused was 100% of the NRB. This percentage is applied to the current NRB of £325,000 to calculate the amount that can be transferred.
- Darya's executors must claim the transferred NRB/RNRB on the submission of her IHT return within two years from her death, or three months after they start to act, if later.

(b) Denys made a lifetime gift to his son

On Denys's death:

- Lifetime gift to son is a PET; therefore no lifetime IHT is due but the gift becomes chargeable on his death
- The PET is covered by the nil rate band available at death, therefore no death IHT is due
- However, the PET utilises £176,700 ($£182,700 - (£3,000 \times 2)$ AEs) of his nil rate band available at death
- The transfer of his estate to Darya is an exempt legacy
- Therefore, after taking account of his lifetime gifts, £123,300 ($£300,000 - £176,700$) of his nil rate band is unutilised
- The unutilised proportion is 41.1% ($(£123,300 / £300,000) \times 100$)

On Darya's death:

	£
Gross chargeable estate	1,050,000
Less: RNRB at date of Darya's death	(175,000)
Less: RNRB transferred from Denys ($£175,000 \times 100\%$)	(175,000)
Less: NRB at date of Darya's death	(325,000)
Less: NRB transferred from Denys ($£325,000 \times 41.1\%$)	(133,575)
	<hr/>
Taxable amount	241,425
	<hr/>
IHT payable on death ($£241,425 \times 40\%$)	96,570
	<hr/>

IHT: Special valuation rules, reliefs and the death estate

Chapter learning objectives

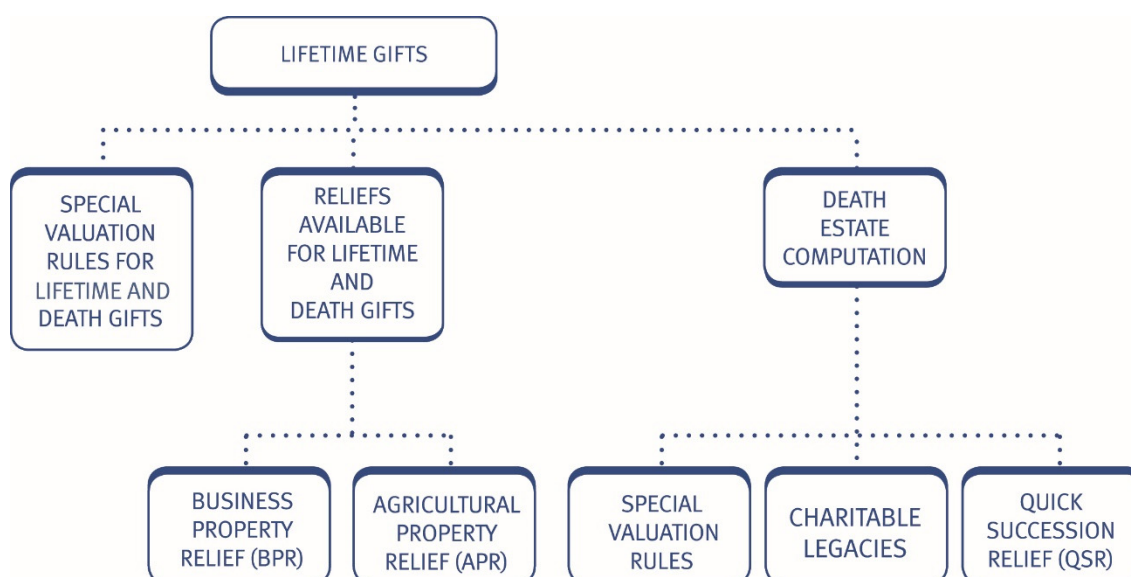
Upon completion of this chapter you will be able to:

- advise on the principles of valuation including the related property rules
- advise on the availability of business property relief and agricultural property relief
- advise on the tax liability arising on a death estate
- advise on the operation of quick succession relief
- advise on the reduced rate of inheritance tax payable when a proportion of a person's estate is bequeathed to charity
- advise on the use of reliefs and exemptions to minimise inheritance tax liabilities.



PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. This includes calculating inheritance tax, which is covered by this chapter. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter covers further considerations which can affect the calculation of IHT on lifetime gifts, special valuation rules that apply to certain assets, reliefs, and the detailed death estate computation.



In TX you studied the basic IHT calculations. The reliefs and special valuation rules in this chapter fit into those basic calculations. You need to be prepared to explain when they are applicable and why, rather than just being able to deal with the figures.

1 Special valuation rules for lifetime gifts and the death estate

As stated in the previous chapter, the transfer of value is normally the **open market value (OMV)** of the asset gifted.

However, there are special rules that apply to the valuation of some assets.



Quoted shares and securities

The value of quoted shares and securities for IHT purposes is computed as follows:

Value = Lower of:

- (1) 'Quarter Up' method
(using the range of prices quoted on the stock exchange on that day)
= lower price + $\frac{1}{4} \times (\text{higher price} - \text{lower price})$.
- (2) Average of the highest and lowest recorded bargains.

Note that these rules are not the same as the valuation rules for CGT (see Chapter 8).

The range of prices quoted is usually the 'cum-dividend' values for shares and 'cum-interest' values for securities.



In the examination, always assume shares and securities are quoted 'cum-dividend' and 'cum-interest' unless the question states otherwise.



Quoted ex-dividend or ex-interest

The capital value of shares and securities quoted ex-dividend or ex-interest is calculated as follows:

	Shares quoted ex-dividend	Securities quoted ex-interest
Value using 'lower of' rule	X	X
Plus: Next dividend payment (amount received)	X	
Plus: Next interest payment (amount received less 20% tax)		X
	—	—
Capital value to include in the estate	X	X
	—	—



Meaning of terminology

Quoted cum-dividend or cum-interest

When shares are quoted 'cum-dividend' this means that:

- if the shares are sold, they are sold **'with'** the right to the next dividend payment
- the shareholder buying the shares will therefore receive the next dividend payment.

Similarly, if securities are quoted 'cum-interest', the person buying the securities will receive the next interest payment.

Quoted ex-dividend or ex-interest

When shares are quoted 'ex-dividend' this means:

- if the shares are sold in this period, they are sold **'without'** the right to the next dividend payment
- the shareholder owning the shares on the date they went 'ex-dividend' will receive the next dividend payment.

Similarly, if securities are quoted 'ex-interest', the owners of the securities on the date they went 'ex-interest' will receive the next interest payment.

Therefore, if an individual dies when shares and securities are quoted 'ex-dividend' or 'ex-interest', that individual's estate will be entitled to the next dividend or interest payment which, in practice, is usually received a few weeks later.

Accrued interest to which the deceased was entitled is included in the death estate net of basic rate tax (20%). This is because the executors will be required to account for income tax at the basic rate to HMRC.



Test your understanding 1

Jeremy owned £100,000 of 10% loan notes in XY plc on the day he died. £100 of the loan notes were quoted at £94 – £98 ex-interest. Interest is paid on the loan notes every six months on 30 June and 31 December.

Calculate the value to include in Jeremy's estate in respect of the loan notes.



Valuation of quoted shares and securities

These valuation rules apply to all quoted shares and securities, including:

- investment trusts
- open ended investment companies (OEICs)
- gilt-edged securities
- venture capital trusts (VCTs)
- real estate investment trusts (REITs).



Unquoted shares and securities

The value of unquoted shares and securities to be used has to be agreed with the HMRC's Shares and Assets Valuations team.

In an examination question, the value of unquoted shares and securities to be used is given in the question.

For a lifetime gift, the diminution in value calculation will be required (as in Test your understanding 1 in Chapter 10).



Unit trusts

Unit trusts are valued at the lowest bid price (i.e. do not use the 1/4 up rule).



Test your understanding 2

Sultan owns 5,000 units in the Growbig Unit Trust. At the time of her death they are quoted at 125p – 133p.

Calculate the value of the unit trusts for IHT purposes.



Related property

'Related property' is a concept unique to IHT.



Property is 'related' to the donor's property if it is **property of a similar kind owned by**

- the **donor's spouse** or civil partner
- an exempt body as a result of a gift from that person, or that person's spouse or civil partner.

An **exempt body** includes a charity, qualifying political party, national body or housing association.

Property held by the exempt body is deemed to be related:

- for as long as that body owns the asset, and
- for five years after they have disposed of it.

In the examination, the most common related property is **property owned by the donor's spouse** or civil partner.

Note that property of a similar kind owned by the donor's children or other family members is **not** related property.

The special valuation rules for related property

The related property valuation rules apply to the valuation of:

- unquoted shares
- collections of antiques and chattels
- adjacent plots of land.

However, in the examination, the related property rules normally apply to unquoted shares.

The related property valuation should be calculated as follows:

$$\frac{A}{A + B} \times (\text{Value of the total combined assets of a similar kind})$$

The meaning of A and B in the formula is slightly different depending on whether the asset is shares or assets other than shares, as follows:

Assets other than shares	Shares
A = Value of the donor's asset	Number of shares held by the donor
B = Value of the related parties' assets	Number of shares held by the related parties



Test your understanding 3

Sara owns two antique chairs which are part of a set of six. Her husband owns another three, and her daughter owns one.

Sara gifts one chair to her son.

The values of the chairs on that date are as follows:

1 chair	£5,000
2 chairs	£15,000
3 chairs	£25,000
4 chairs	£40,000
5 chairs	£60,000
6 chairs	£90,000

Calculate the transfer of value relating to the gift of one chair for IHT purposes.



Illustration 1 – Related property

Ordinary shares in Monsoon Ltd, an unquoted trading company, with an issued share capital of 100 shares of £1 each, are held as follows:

	% of shares (before the gift)
Fredrik	40
Maja – his wife	35
Mikael – his son	15
Ebba – his daughter	10
	—
	100
	—

Fredrik gave 5% of his shares to his daughter.

The value of the shares on the date of the gift was as follows:

	£
100%	150,000
75%	105,000
70%	80,000

Compute the value of the gift to the daughter for IHT purposes before exemptions and reliefs.

Solution

	Before the gift % holding	After the gift % holding
Fredrik	40%	35%
Maja – wife	35%	35%
	<hr/>	<hr/>
	75%	70%
	<hr/>	<hr/>
Total value	£105,000	£80,000
Value of Fredrik's shares before (40/75) × £105,000		£ 56,000
Value of Fredrik's shares after (35/70) × £80,000		(40,000)
		<hr/>
Transfer of value		16,000
		<hr/>

**Test your understanding 4**

James gave his son 6,000 ordinary shares in Simons Ltd, an unquoted trading company.

The company's share capital immediately before the transfer comprised 20,000 ordinary shares held as follows:

	Number
James	8,000
His wife	2,000
His brother	5,000
His sister	3,000
His father	2,000
	<hr/>
	20,000
	<hr/>

The agreed values for the shares at the time of the gift were:

Holding	£
75% or more	10
50.01% – 74.99%	8
50% exactly	7
30% – 49.99%	6
10% – 29.99%	4
Under 10%	3

Calculate the transfer of value relating to the gift of shares for IHT purposes.



The need for special related property rules

The special related property valuation rules prevent a married couple or civil partnership from deliberately splitting the ownership of similar assets to avoid IHT.

Consider the following scenario:

- (i) On 1 July 2023 Joe owned 60% of the share capital of XYZ Ltd, an unquoted company. This shareholding was valued at £600,000.

If Joe were to die on that day the £600,000 would be charged to IHT.

- (ii) On 2 July 2023 Joe gave 30% of the XYZ Ltd shareholding to his civil partner. This transfer, being to a civil partner, is exempt from IHT.

A 30% shareholding in XYZ Ltd valued in isolation is worth £200,000.

Without any special rules, if Joe and his civil partner were to die on that day only £400,000 ($2 \times £200,000$) would be charged.

Two 30% shareholdings are worth less than a 60% shareholding because a 60% holding gives control, whilst a 30% holding is only a minority interest.

- (iii) Assume that on 3 July 2023 both Joe and his civil partner died.

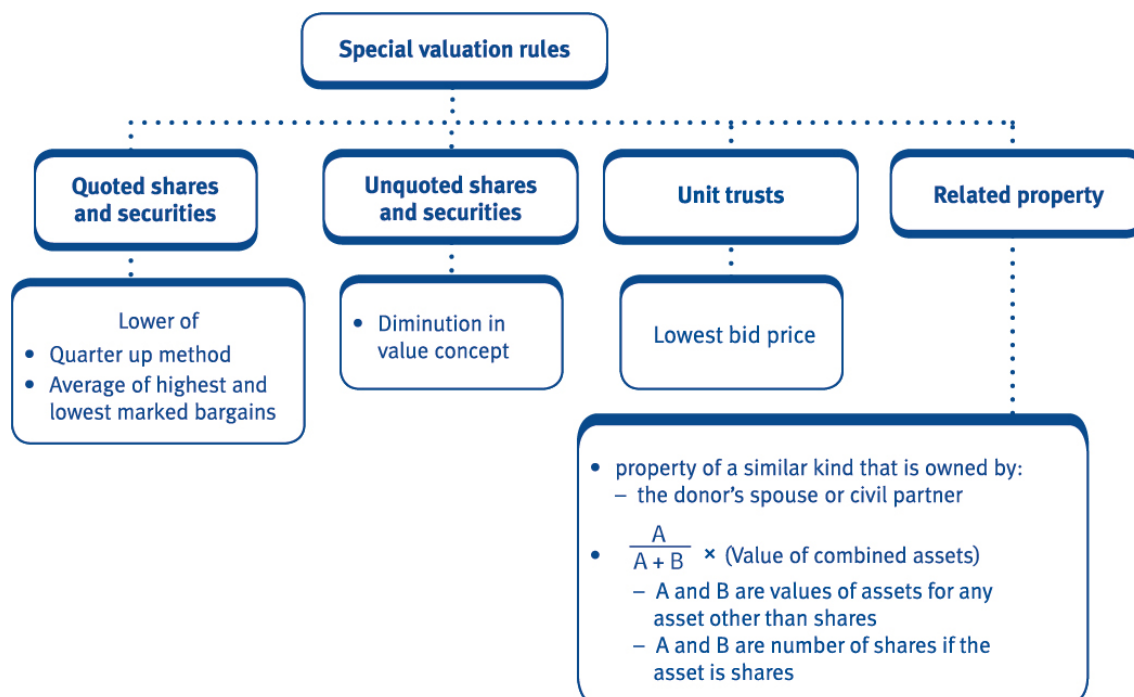
Without the related property rules, the estates of Joe and his civil partner would each include shares valued at £200,000 based on 30% shareholdings and a total of £400,000 is subject to IHT.

However, if Joe had not made the inter-spouse transfer, the 60% interest valued at £600,000 would be chargeable. Therefore, without the special valuation rules, by splitting the interest between the couple, £200,000 of value would escape IHT.



Since the related property valuation will almost always give a higher valuation than that ignoring any related property holding, this will always be the default assumption at ATX (UK), unless specific direction is given to the contrary.

Summary of special valuation rules



2 Key reliefs available for lifetime and death transfers

There are two key reliefs that are available for both lifetime gifts and transfers on death:

- Business property relief (BPR).
- Agricultural property relief (APR).



3 Business property relief

Business property relief (BPR) is a very important relief that significantly reduces the value of lifetime gifts and the value of an individual's death estate if certain conditions are satisfied.



The relief:

- is given automatically if the conditions are satisfied, no claim is required
- reduces the transfer of value by either 50% or 100%, depending on the type of business property being transferred
- applies to worldwide relevant business property
- applies to both lifetime transfers and the death estate valuation
- on lifetime gifts, is deducted from the transfer of value **before** any other exemptions or reliefs.

Conditions to be satisfied

To qualify for BPR, there are two key conditions which must be satisfied:

- The property must be relevant business property.
- It must have been held for the minimum period of ownership.

Relevant business property



BPR is given on the following property and at the following rates:

Type of property		% relief
Unincorporated business	<ul style="list-style-type: none"> • e.g. a whole sole trade business or partnership interest 	100%
Unquoted shares and securities	<ul style="list-style-type: none"> • including AIM listed shares and securities • relief on shares is available regardless of the number of shares held • relief is also available for securities in an unquoted company, but only if the individual has voting control of the company immediately before the transfer based on share ownership 	100%
Quoted shares and securities	<ul style="list-style-type: none"> • relief is only available if the individual has voting control of the company immediately before the transfer 	50%
Land, buildings, plant or machinery used in a business	<ul style="list-style-type: none"> • relief is only available if carried on by: <ul style="list-style-type: none"> – a company in which the donor has control – a partnership in which the donor is a partner 	50%

Note that:

- to qualify, an unincorporated business must be a **trading** business and the companies in which the individual has shares must be **trading** companies.
- to determine control, **related property holdings** must be considered.
- BPR is not available if the asset concerned is subject to a **binding contract for sale** at the date of transfer.

The most common example of where this happens is where a partnership agreement provides for the interest of a partner to be sold to the other partners in the event of death. As a binding contract of sale exists, no BPR is available.

However, if the agreement provides an option for the other partners to purchase the interest, but not a binding obligation to do so, BPR would be available.



Test your understanding 5

Judeline owns the following assets:

- (1) 45% of the ordinary share capital of ABC plc, a quoted trading company.
- (2) 15% of the ordinary share capital of DEF Ltd, an unquoted trading company.
- (3) A factory owned personally by Judeline, but used in a partnership of which Judeline is not a partner.
- (4) 35% of the ordinary share capital of GHI plc, a quoted trading company. Judeline's husband also owns 12% of the share capital, and Judeline's daughter owns a further 6%.
- (5) A 25% shareholding in Green Ltd, an AIM listed trading company.

State whether Judeline's assets qualify as relevant business property, and if so state the amount of BPR that will be given.

Minimum period of ownership



To qualify for BPR, the relevant business property must have been held for a minimum period of **two years** immediately preceding the transfer.

If the asset was inherited on the death of a spouse or civil partner, the couple's combined ownership period is taken into account.



Illustration 2 – Business property relief

Peter inherited an unincorporated business from his wife on 1 January 2022. Peter died on 30 June 2023. Peter's wife had owned the property for one year.

State whether BPR is available on the unincorporated business on Peter's death.

Solution

Although Peter has owned the property for only 18 months, BPR will be available since his wife's one year period of ownership can be included to make a total combined period of ownership exceeding two years.

Exceptions to the two year qualifying rule

There are two key situations where the two year qualifying rule is not satisfied but BPR is still available. They are as follows:

- Replacement property

BPR is still available where

- the relevant business property has not been held for two years because it **replaced** business property previously held, **and**
- the individual owned some type of relevant business property for a combined period of ownership of at least **two out of the last five years**.

BPR is given on the lower of the two property values (i.e. it cannot exceed the BPR that would have been given on the original property).

- Successive transfer

BPR is still available where

- the relevant business property held was eligible for BPR **at the time it was acquired**, and
- it was either acquired as a result of death, or is now chargeable as a result of death.



Test your understanding 6

On 31 December 2022, an unquoted trading company JKL Ltd was taken over by MNO Ltd, another unquoted trading company. Marsha had owned ordinary shares in JKL Ltd for four years before the takeover. The consideration on the takeover consisted of ordinary shares in MNO Ltd.

On 30 June 2023, Marsha gifted her shares in MNO Ltd to her sister. The shares in MNO Ltd were worth £160,000. She had made no other lifetime gifts.

Her shares in JKL Ltd had been worth £110,000 on 31 December 2022.

Calculate the gross chargeable amount of Marsha's lifetime gift to her sister.

Excepted assets



To qualify for BPR, an unincorporated business must be a **trading** business and the companies in which the individual has shares must be **trading** companies. There is no relief for interests in an investment business.

However, an individual may own an interest in a trading business but that business owns some investment assets (known as 'excepted assets'). Where this is the case, BPR is available but the amount of relief is restricted.



Investment activities

The following investment activities prevent BPR from being available:

- dealing in securities, stocks and shares
- dealing in land and buildings
- making or holding investments, which includes the holding of land and buildings that are let.



Definition of excepted assets

An 'excepted asset' is an asset that:

- has not been used wholly or mainly for business purposes throughout the preceding two years, and
- is not likely to be required for future use in the business.

The main examples of excepted assets are:

- large cash balances in excess of reasonable business requirements
- investments in shares and securities
- investments in land and buildings which are let.

Restriction of BPR

On the transfer of an unincorporated business, BPR is only available on the business assets. No relief is available for excepted assets.

On the transfer of shares in a company that has excepted assets, BPR is only available on the business asset proportion of the total assets in the business, calculated as follows

$$\text{Transfer of value} \times \frac{\text{Value of total assets less value of excepted assets}}{\text{Value of total assets}}$$



Test your understanding 7

On 31 May 2023, Eduarda gifted 40,000 shares in STU Ltd, an unquoted trading company to her niece on the occasion of her marriage. Eduarda had owned the shares since 2008 and on 31 May 2023 the shares were worth £180,000.

On that date, STU Ltd owned assets worth £500,000 which included an investment property valued at £50,000.

Eduarda had made no other lifetime transfers.

Calculate the gross chargeable amount of Eduarda's lifetime gift.

Withdrawal of BPR on death

If conditions are not satisfied at the date of death, BPR is withdrawn when calculating the IHT payable on lifetime gifts due to the death of the donor.

The detailed rules for the withdrawal of BPR are covered below.



Withdrawal of BPR on death

For lifetime gifts:

- The conditions for BPR are considered at the time of the gift and BPR is given at the appropriate rate when calculating the chargeable amount of a CLT or PET.
- If the gift becomes chargeable on death, BPR must be considered again at the time of death.
- BPR is available again on the death calculation provided:
 - the asset is still relevant business property at the date of death, and
 - the donee still owns the business property (or replacement business property) at the date of the donor's death (or the date of the donee's death, if the donee predeceased the donor).
- If these two conditions are not satisfied, BPR is withdrawn and is not available in the death calculation.
- If BPR is withdrawn on a CLT the original chargeable amount including relief is used for NRB cumulation.



4 Agricultural property relief

Agricultural property relief (APR) is very similar to BPR, but gives relief for transfers of agricultural property.

The relief:

- is given automatically if the conditions are satisfied, no claim is required
- reduces the transfer of value by 100%
- applies to both lifetime transfers and the death estate valuation
- on lifetime gifts, is deducted from the transfer of value first, **before** any other exemptions and before other reliefs (including BPR).

Conditions to be satisfied

To qualify for APR, there are two key conditions which must be satisfied:

- the property must be relevant agricultural property
- it must have been held for the minimum period of ownership.

Relevant agricultural property

APR is given at a rate of 100% on the **agricultural value** of **agricultural property**.

Agricultural value

The agricultural value is the value of the land and buildings assuming there is a perpetual covenant on the land preventing any other use of the land other than agriculture.

It is likely that the commercial value of the farming land and business will be considerably higher due to its development potential.

The difference between the market value of the business and the agricultural value is often referred to as the development value.

Agricultural property

Agricultural property is defined as the agricultural land and buildings.

Agricultural property therefore includes:

- farm land and pasture
- farm buildings, including the farmhouse, cottages, barns, pig sheds, milking parlours etc.

Unlike BPR, APR is not available on worldwide agricultural property. APR is only **available if the property is situated in the UK, the EEA, the Channel Islands or the Isle of Man**.

As with BPR, APR is not available if the asset concerned is subject to a **binding contract for sale** at the date of transfer.



APR at 50%

APR is available at 100% on most agricultural property.

However, only 50% relief is available if a farm is:

- a tenanted farm, and
- the lease was taken out before 1 September 1995, and
- at the date of transfer the owner does not have the right to obtain vacant possession within the next two years.

Minimum period of ownership

To qualify for APR, the agricultural property must have been held for the following minimum periods:

Agricultural property farmed by:

- the owner
- a tenant

Minimum ownership period:

Two years

Seven years



Exceptions to the minimum period

The same exceptions to the rule for BPR apply to APR (i.e. the replacement property provisions and successive transfers rule).

However, the replacement property rules are slightly different. APR is available where:

- the individual owned some type of relevant agricultural property for a combined period of ownership of:
 - at least **two** out of the last **five years** if farmed by the owner
 - at least **seven** out of the last **ten years** if farmed by a tenant.

The interaction of APR and BPR

Where agricultural property forms part of an unincorporated farming business, APR is given before BPR. Double relief is not available on the same value.

However, APR is only available on the agricultural value. Therefore, subject to the relevant conditions for BPR being met, BPR will then be available on any value of the remaining business assets that do not qualify for APR.

Note that if the farm is tenanted and it is not the owner's farming business, no BPR is available on the remaining business assets as they are investment assets, not the owner's trading assets.



Test your understanding 8

Zac plans to gift his farming business and £20,000 cash to his grandson on the occasion of his marriage in the tax year 2023/24. He has made no other lifetime gifts in the preceding seven years.

Zac lives on the farm and has owned and worked the business for the last seventeen years.

A surveyor has recently valued Zac's farm and its land as follows:

	£
Agricultural value	600,000
Development value	400,000
	<hr/>
Market value of farm land and buildings	1,000,000
Animals and inventory	150,000
Plant and machinery and motor vehicles	80,000
	<hr/>
Market value of farming business	1,230,000
	<hr/>

Calculate the chargeable amount of Zac's gift to his grandson.



Shares in a farming company

APR is available in respect of shares in a farming company provided:

- the individual has control of the company
- the minimum period of ownership condition is satisfied.

Note that:

- to determine control, **related property holdings** must be considered (see above).
- APR is only given against the agricultural value that can be attributed to the shares. BPR may be due on some or all of the remainder.
- APR will be restricted where the farming company holds excepted assets in the same way as for BPR.



Illustration 3 – Agricultural property relief

Since 2009, Jada has owned a 75% shareholding in Arable Ltd, an unquoted trading company which owns farm land.

On 31 October 2023 Jada gifted the shares to her daughter when they were worth £375,000 and the accounts of Arable Ltd show:

	£
Farm land	350,000
Other assets	150,000
	<hr/>
	500,000
	<hr/>

The farm land has been let to tenants for the previous nine years.

The agricultural value of the farm land was £300,000. The other assets of £150,000 were all used in Arable Ltd's trade.

Calculate the gross chargeable amount of the gift to Jada's daughter.

Solution

APR is available as:

- Arable Ltd's farm land has been let out for the previous nine years
- Jada has a controlling shareholding in the company.

In addition, as the shareholding is in an unquoted company, BPR is available on any amount that does not qualify for APR, subject to the relevant BPR conditions being satisfied.

	£
Transfer of value – shares in farming company	375,000
Less: APR on agricultural value (Note)	
$(£300,000/£500,000) \times £375,000 \times 100\%$	(225,000)
BPR on Arable Ltd's other assets	
$(£150,000/£500,000) \times £375,000 \times 100\%$	(112,500)
Less: AE – 2023/24	(3,000)
– 2022/23 b/f	(3,000)
	<hr/>
Gross chargeable amount	31,500
	<hr/>

Note: APR is only available on the agricultural value of the farm land that can be attributed to the shares transferred. BPR is available on the value that can be attributed to the business assets in Arable Ltd (i.e. the 'other assets'). BPR is not available on the development value of the farm land attributed to the shares as the farm is tenanted (i.e. not owned and farmed by Arable Ltd).

Withdrawal of APR on death

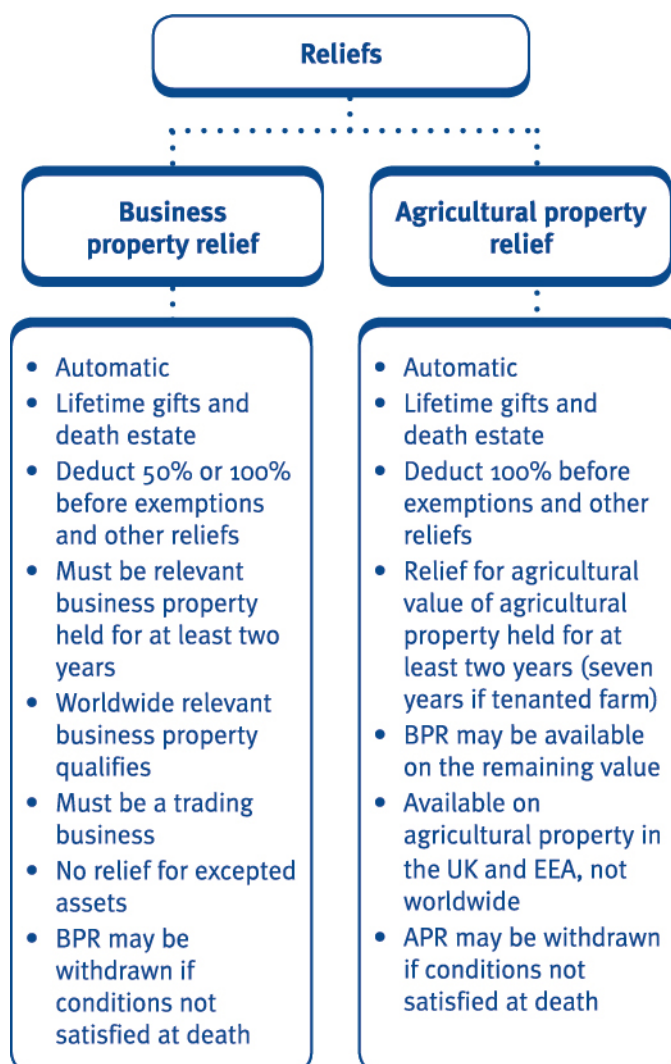
In the same way as for BPR, if conditions are not satisfied at the date of death, APR is withdrawn when calculating the IHT payable on lifetime gifts due to the death of the donor.



Withdrawal of APR on death

- For lifetime gifts, the conditions for APR are considered at the time of the gift and APR is given at the appropriate rate when calculating the chargeable amount of a CLT or PET.
- If the gift becomes chargeable on death, APR must be considered again at the time of death. APR is available again on the death calculation provided:
 - the asset is still relevant agricultural property at the date of death, and
 - the donee still owns the agricultural property (or replacement property) at the date of the donor's death (or at the date of the donee's death, if the donee predeceased the donor).
- If these two conditions are not satisfied, APR is withdrawn and is not available in the death calculation.
- If APR is withdrawn on a CLT the original chargeable amount including relief is used for NRB cumulation.

5 Summary of reliefs available for lifetime and death transfers



6 The death estate computation

The death estate includes all assets held at the date of death.

The value of assets brought into an individual's estate computation is normally the **open market value (OMV)** of the asset at the date of death (known as the probate value).

However, as we have seen, there are special rules that apply to the valuation of some assets.

The gross chargeable value of an individual's estate is calculated using the following pro forma:

Pro forma death estate computation

	£	£
Property	X	
Less: Repayment and interest-only mortgages	(X)	
	—	X
Foreign property* (see Chapter 12)	X	
Less: Expenses (restricted to maximum 5% of property value)	(X)	
	—	X
Business owned by sole trader/partnership*		X
Farm*		X
Stocks and shares (including ISAs)*		X
Government securities		X
Insurance policy proceeds		X
Death in service policy		X
Cars		X
Personal chattels		X
Debts due to the deceased		X
Interest and rent due to the deceased		X
Cash at bank and on deposit (including ISAs)		X
		—
		X
Less: Debts due by the deceased	(X)	
Outstanding taxes (e.g. IT, CGT due)	(X)	
Funeral expenses (not executor's fees)	(X)	
	—	(X)
		—
		X
Less: Exempt legacies (e.g. to spouse, charity, political party)		(X)
		—
Net free estate		X
Add: Gift with reservation (GWR) (Chapter 12)		X
		—
Gross chargeable estate		X
		—

Note that

- * These items may be reduced by BPR/APR if conditions are satisfied
- All net assets are included in the estate (including cars, ISAs etc.) as there are no exempt assets for IHT.

The IHT liability on the estate value is then calculated as follows:

	£
IHT on chargeable estate (per Chapter 10)	X
Less: Quick succession relief (QSR) (section 11)	(X)
	<hr/>
	X _A
Calculate the average estate rate (AER)	
= (X _A /chargeable estate) × 100	
Less: Double tax relief (DTR) (see Chapter 12)	
Lower of:	
(i) Overseas tax suffered	
(ii) AER × overseas property value in estate	(X)
	<hr/>
IHT payable	X
	<hr/>

Due date: Earlier of

- six months after end of month of death
- on delivery of estate accounts to HMRC

Allocation of IHT payable:

- The IHT payable on the estate is apportioned between different elements of the estate at the AER (after QSR).
- The tax on a GWR is payable by the beneficiary receiving the GWR.
- The remaining tax on death is initially paid by the executors.
However, where there is overseas property, it is then apportioned between the UK and overseas element of the estate.
- The tax relating to the overseas property (after DTR) is recovered from the person inheriting the asset (i.e. the specific legatee).
The gift of foreign property from an estate is therefore referred to as a 'tax bearing legacy'.
- The remainder of the tax relating to the UK assets is paid from the estate, and so is effectively borne by the person who inherits the residue of the assets after the specific legacies have been paid (known as the residuary legatee).
Accordingly, specific legacies of UK assets do not bear any tax and are referred to as 'tax-free legacies'.



Allowable deductions in the death estate computation

Funeral expenses

The costs of the individual's funeral are **allowable** providing they are reasonable, even though the cost is incurred after the date of death.

Reasonable costs of mourning clothes for the family and the cost of a tombstone are also allowable.

Costs of administering the estate

The cost of administering the estate by the executors/personal representatives is **not an allowable deduction** as it is for professional services carried out after the death.

Other allowable deductions

Debts are deductible if they:

- were outstanding at the date of death, and
- had been incurred for valuable consideration, or were imposed by law (i.e. legally enforceable debts).

Note that a 'promise' to pay a friend is not legally enforceable and therefore not deductible.

Gambling debts are only deductible if legally enforceable (e.g. an amount owed to a casino) and not unenforceable (e.g. an amount owed to a friend).

This will include all outstanding taxes such as income tax, NICs and CGT, although not the IHT due on death itself.

If a debt is secured against specific property it is deducted from the value of that property. This will be the case with a repayment, or interest-only mortgage secured against property (see death estate pro forma).

Exempt legacies

The only exempt legacies that are allowable in the death estate are gifts to:

- the spouse or civil partner
- a charity
- a qualifying political party.

The detail of these exemptions has been covered in Chapter 10.

Relief

- BPR and APR may be available to reduce the value of an individual's death estate.

Transfer of ISA on death

On death, if ISA savings are left to the spouse or civil partner:

- the gift is an exempt legacy, and
- in addition, an ISA allowance equal to the deceased individual's ISA savings can be claimed by the surviving spouse or civil partner (Chapter 18).

As a result, the deceased individual's ISA savings will retain their beneficial tax treatment (i.e. exemption from income tax and capital gains tax) in the future, in the hands of the surviving spouse or civil partner.

Note however that the surviving spouse or civil partner is entitled to the allowance even if the ISA assets are left to someone else.

If this is the case, there will be no exempt legacy in the death estate computation, but the surviving spouse will be able to invest an additional amount of funds into an ISA to benefit from the ISA exemptions in the future.



Test your understanding 9

Tom died on 30 June 2023 leaving the following assets:

	£
House	200,000
Cottage	250,000
Unincorporated business	400,000
Bank account	75,000
Quoted shares in a trading company	100,000
Car	15,000

At the date of his death Tom owed £2,000 on his credit card, and £3,000 of income tax and CGT. Tom has owned the business for 20 years.

In Tom's will he left

- the business, the house and shares to his wife
- the cottage to his brother
- the residue to his sister.

Tom made a lifetime gift of £115,000 in cash to his son in August 2019.

Compute the IHT payable on Tom's death.



7 Special valuation rules affecting the death estate

Land and freehold property situated in the UK

When land and property is owned by two or more individuals, they own the property as either 'joint tenants' or 'tenants in common' which means that on the death of a tenant, that tenant's share is inherited:

Joint tenants	Tenants in common
<ul style="list-style-type: none"> automatically by the other tenant(s) 	<ul style="list-style-type: none"> in accordance with the terms of the deceased tenant's will, or in accordance with the rules of intestacy.

The valuation of the UK land and property to be included in the estate computation is the appropriate proportion of the value of the whole property for joint tenants. Usually this is one half of the whole as there are normally two joint tenants.

For tenants in common the value is negotiated and agreed with HMRC, but for the examination assume the value is 10% lower than the OMV.



Illustration 4 – Tenants in common

A brother and a sister jointly own a property as tenants in common worth £500,000.

Calculate the value of the brother and sister's share in the property for IHT purposes if they were to consider making a transfer of their share in the property.

Solution

The value of half the property would be on a 'stand-alone' basis. This is the OMV of the half share of the property on the open market which is unlikely to be 50% of the whole value.

However, who would buy half a house?

The Capital Taxes Division of HMRC accepts that a 'tenanted deduction' of between 5% to 15% from the OMV is appropriate for IHT valuation purposes.

For exam purposes, always assume a deduction of 10%.

	£
Half the value of the property (£500,000 × 1/2)	250,000
Less: 10% deduction	(25,000)
	<hr/>
Value of the half share for IHT purposes	225,000
	<hr/>

Life assurance policies

The IHT valuation of a life assurance policy (LAP) is as follows:

Terms of the policy	Value to include in the estate
LAP taken out on one's own life	Actual proceeds received by the estate
LAP written specifically for the benefit of a named beneficiary (e.g. the spouse and/or children) under a declaration of trust	Excluded from the estate

Note that:

- For a death in service policy (i.e. an insurance policy taken out by an employer on the life of an employee), in the event that the employee dies, the insurance company will pay out a lump sum to the beneficiaries of the estate. This lump sum forms part of the deceased's death estate.



8 Reduced rate of IHT for substantial legacies to charity

A reduced death rate of 36% applies to estates in which 10% or more of the 'baseline amount' is left to a qualifying charity.

The 'baseline amount' is the taxable estate:

- after deducting exemptions, reliefs and available nil rate band, but
- before deducting the charitable legacies and the residence nil rate band.

Method for calculating the appropriate rate of tax to apply:

- (1) Add back the residence nil rate band and charitable legacies to the taxable estate
= 'baseline amount'.
- (2) Calculate 10% of the 'baseline amount' and compare to the amount of charitable legacies left on death.
- (3) Tax the taxable estate at the following rate:
If charitable legacies \geq 10% rule: 36%
If charitable legacies $<$ 10% rule: 40%.

**Test your understanding 10**

Han died on 1 May 2023 leaving an estate consisting of:

Family home	£445,000
Quoted shares	£145,000
Cash	£67,000

Han owed tax of £3,200 at his death. In his will he left the shares to his wife, the family home to his children and £67,000 to Oxfam, a UK registered charity.

Han had made one lifetime gift to his son of £310,000 on 10 April 2020.

Calculate the amount of IHT due as a result of Han's death.

Tax planning

IHT may be saved by increasing a charitable legacy, using a deed of variation (see Chapter 12), to ensure that:

- the charitable donations exceed the 10% rule, and
- thereby reduce the tax on the whole estate to 36%.

9 Comprehensive example – death estate

The following example involves a death estate computation using the special valuation rules.

**Test your understanding 11**

Wilma died on 4 October 2023.

Under the terms of her will, the estate was left as follows:

- £120,000 to her husband
- £50,000 to the Conservative Party
- the residue of the estate to her son Joe.

At the date of her death, Wilma owned the following assets.

- (1) Her main residence valued at £628,000.
- (2) A flat in London valued at £150,000. Wilma had never lived in this property.
- (3) Four shops valued at £50,000 each. Wilma's husband Fred owns two adjacent shops valued at £60,000 each. The combined value of all six shops is £370,000.
- (4) A villa situated overseas worth \$200,000. The exchange rate on 4 October 2023 was \$10 to £1.

- (5) A half share of a partnership business which is valued at £400,000 in total. The partnership trades in the UK. Wilma had been a partner for several years.
- (6) 20,000 shares in ZAM plc. The shares were quoted at 198p – 206p, with bargains of 196p, 199p and 208p.
- (7) 8,000 units in the CBA unit trust, valued at 130p – 136p.
- (8) Bank balances of £57,850.

Wilma's outstanding income tax liability was £7,500, and her funeral expenses amounted to £2,000. She had made no lifetime gifts.

Calculate the IHT that will be payable as a result of Wilma's death.

Explain who will pay and who will suffer the IHT liability.

10 Reliefs available against the IHT liability on the death estate

There are two tax credit reliefs that **reduce the IHT liability on the death estate** as follows:

	£
IHT on chargeable estate	X
Less: Quick succession relief (QSR)	(X)
Double tax relief (DTR) (See Chapter 12)	(X)
	—
UK inheritance tax payable	X
	—



11 Quick succession relief

Quick succession relief (QSR) applies where an individual dies and **within the previous five years** they had:

- **inherited an asset** on someone else's death, and IHT was charged on the inheritance, or
- **received a lifetime gift**, and IHT was charged on the gift.

The most common situation is where two members of a family die within a five year period, the first person to die having made a bequest to the second person.

QSR is a **tax credit** against the IHT liability of an estate on the death of the individual receiving the asset.

The amount of QSR where two deaths occur within a five year period is calculated as follows:

$$\text{QSR} = (\text{IHT on first death}) \times (\text{Appropriate percentage})$$

The appropriate percentages are as follows:

Years between first transfer and date of death		Appropriate percentage used in formula above
More than	Not more than	
0	1	100%
1	2	80%
2	3	60%
3	4	40%
4	5	20%

The IHT paid on the first death is either given in the question or can be calculated as follows:

$\frac{\text{Total IHT paid on first death estate}}{\text{Gross chargeable estate value of first death}} \times \text{Value of asset gifted out of the first estate}$

The following points should be noted:

- **The appropriate percentages are not given in the examination.**
However, note that:
 - the closer the first transfer and date of death, the greater the percentage
 - each additional year between the gifts reduces the percentage by 20%.
- It is not necessary for the individual who received the asset to still own that asset on the date of death. Even though the same asset is not subject to a double charge to IHT as it is not included in the second estate, QSR is still available. This is because the second person's estate will have a higher value following the receipt of the gift whether the original property is retained, exchanged for other property or is converted into cash.
- QSR is given **before** DTR.



Test your understanding 12

Reem died on 31 July 2023 leaving an estate of £340,000. She had made no lifetime gifts and her estate did not include residential property.

In June 2019, Reem had been left £28,000 from her brother's estate. Inheritance tax of £75,000 was paid on a total chargeable estate of £450,000 as a consequence of her brother's death.

Calculate the IHT payable on Reem's death.



Legacies left on death and single grossing up

The terms of a person's will are very important in determining the amount of IHT payable on death.

This section summarises rules already covered in relation to exempt legacies and gifts of specific UK assets to a chargeable person, but extends the situation to cover exempt residues where special rules apply.

Exempt legacy

Gifts to the following persons are exempt from IHT on death:

- Spouse or civil partner.
- Charity.
- Qualifying political party.

Where an exempt person is left a legacy in a will, the amount of the legacy is deducted in the calculation of the gross chargeable estate.

Specific gift of UK assets left to a chargeable person

Where a chargeable person is left a legacy of a specific UK asset, the IHT on the legacy is borne by the residuary legatee (i.e. the person who is left the residue of the estate in the will) not the specific legatee who receives the asset. The specific gift is a 'tax free' legacy.

For example, if you are left £100,000 in your grandfather's will, you will receive all £100,000. The IHT payable on the gift to you is borne by the person who is left the residue of your grandfather's estate.

This will cause no problems in the calculation of IHT where the residuary legatee is a chargeable person. However, where the residuary legatee is an exempt person, special rules apply to calculate the IHT on the estate.

Exempt residue

Special rules known as 'single grossing up' (SGU) are required where the terms of the deceased's will (or the rules of intestacy) leave gifts from the estate as follows:

- specific gift(s) of UK assets are left to a chargeable person(s), and
- the residue of the estate is left to an exempt person.

To find the IHT payable it is necessary to calculate the amount of chargeable assets that would be needed so that **after** the tax was paid, the amount left will pay the specific legacies.

The total of the specific gifts of UK assets is the **net** chargeable estate.

Accordingly, the IHT payable is calculated as:

$(\text{Net chargeable estate} - \text{NRB available}) \times 40/60$.

Note that the gross death rate of tax applied to the gross chargeable estate is 40% on the excess over the NRB available. Therefore the net rate of death tax is 40/60.

Once the IHT payable is calculated, the gross chargeable estate can be calculated as:

$(\text{Net chargeable estate} + \text{IHT payable})$

The amount allocated to the exempt residuary legatee will be the balancing amount.



Illustration 5 – Single grossing up

Aline was a wealthy client of yours. Her estate value is £900,000 and she had made no lifetime gifts.

By her will she left the following gifts:

- Holiday cottage £180,000 to her son. Aline had never lived in the cottage.
 - Legacies of £110,000 each in cash to her two daughters.
 - Legacy of £50,000 cash to charity.
 - Residue to her civil partner.
- (a) **Compute the gross chargeable estate value, the IHT payable and the amount of residue which will pass to Aline's civil partner.**
- (b) **Calculate how your answer would differ if Aline had made gross chargeable lifetime gifts of £267,000.**

Solution

(a) Estate computation

	£
Estate value	900,000
Less: Exempt legacies	
Charity	(50,000)
Civil partner (balancing figure)	(400,000)
	<hr/>
Gross chargeable estate (W)	450,000
	<hr/>
IHT liability on the estate value (W)	50,000
	<hr/>

Distribution of the estate	£
Residue to civil partner	400,000
Gift to charity	50,000
Cottage to son	180,000
Legacies to daughters ($£110,000 \times 2$)	220,000
IHT on legacies to HMRC	50,000
	<hr/>
	900,000
	<hr/>

Working: Single grossing up

Specific chargeable legacies	£
Holiday cottage to the son	180,000
Legacies to the daughters ($£110,000 \times 2$)	220,000
	<hr/>
Net chargeable estate	400,000
	<hr/>
IHT liability on estate:	
Net chargeable estate value	400,000
Less: NRB available	(325,000)
	<hr/>
Taxable amount	75,000
	<hr/>
IHT on death ($£75,000 \times 40/60$)	50,000
	<hr/>
Gross chargeable estate	
($£400,000 + £50,000$)	450,000
	<hr/>

(b) Estate computation

	£
Estate value	900,000
Less: Exempt legacies	
Charity	(50,000)
Civil partner (balancing figure)	(222,000)
	<hr/>
Gross chargeable estate (W)	628,000
	<hr/>
IHT liability on the estate value (W)	228,000
	<hr/>

Distribution of the estate

	£
Residue to civil partner	222,000
Gift to charity	50,000
Cottage to son	180,000
Legacies to daughters	220,000
IHT on legacies to HMRC	228,000
	<hr/>
	900,000
	<hr/>

Working: Single grossing up

		£
Specific chargeable legacies		
Holiday cottage to the son		180,000
Legacies to the daughters ($£110,000 \times 2$)		220,000
		<hr/>
Net chargeable estate		400,000
		<hr/>
IHT liability on estate:		
Net chargeable estate value		400,000
NRB @ date of death	325,000	
Less: GCTs < 7 yrs before death	(267,000)	
NRB available	<hr/>	(58,000)
		<hr/>
Taxable amount		342,000
		<hr/>
IHT on death ($£342,000 \times 40/60$)		228,000
		<hr/>
Gross chargeable estate ($£400,000 + £228,000$)		628,000
		<hr/>

**Illustration 6 – Single grossing up**

Tala died on 30 September 2023 leaving an estate valued at £664,000. This does not include any residential property.

Under the terms of her will Tala left £331,000 to her son Charbel and the residue of the estate to her widow. Tala had made no lifetime gifts.

- Calculate the IHT payable on Tala's death.**
- Show how Tala's estate will be distributed between the beneficiaries.**
- Show how the situation would change if Tala's widow was left £331,000 and Charbel was left the residue of the estate.**

Solution**(a) Estate computation**

	£
Estate value	664,000
Less: Exempt legacies	
Spouse (balancing figure)	(329,000)
	<hr/>
Gross chargeable estate (W)	335,000
	<hr/>
IHT liability on the estate value (W)	4,000
	<hr/>

Working: Single grossing up

Specific chargeable legacies	£
Cash to the son = Net chargeable estate	331,000
	<hr/>
IHT liability on estate:	£
Net chargeable estate value	331,000
Less: NRB available	(325,000)
	<hr/>
Taxable amount	6,000
	<hr/>
IHT on death ($£6,000 \times 40/60$)	4,000
	<hr/>
Gross chargeable estate ($£331,000 + £4,000$)	335,000
	<hr/>

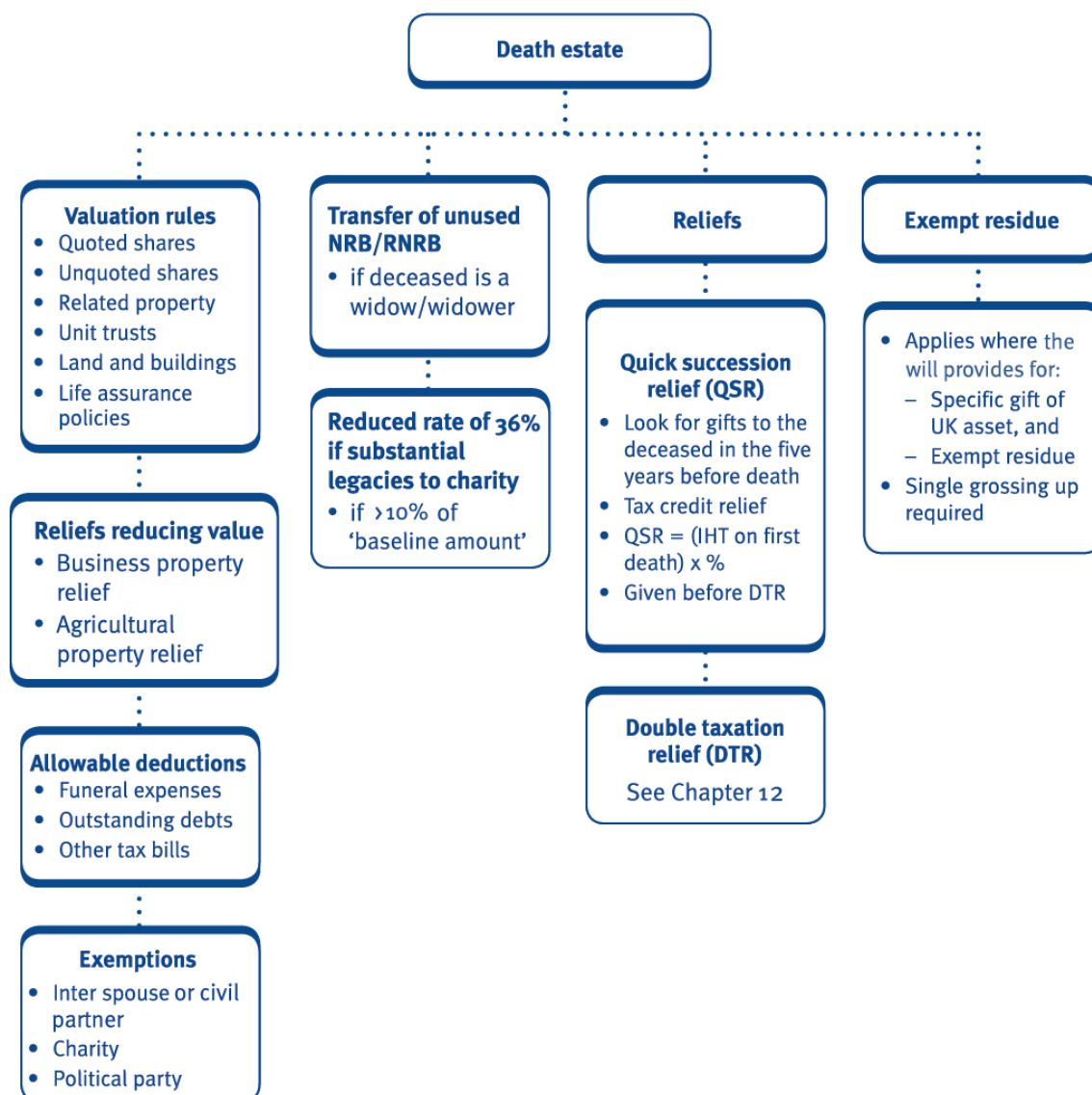
(b) Distribution of the estate

	£
Residue to spouse	329,000
Cash to son	331,000
IHT on Charbel's legacy to HMRC	4,000
	<hr/>
	664,000
	<hr/>

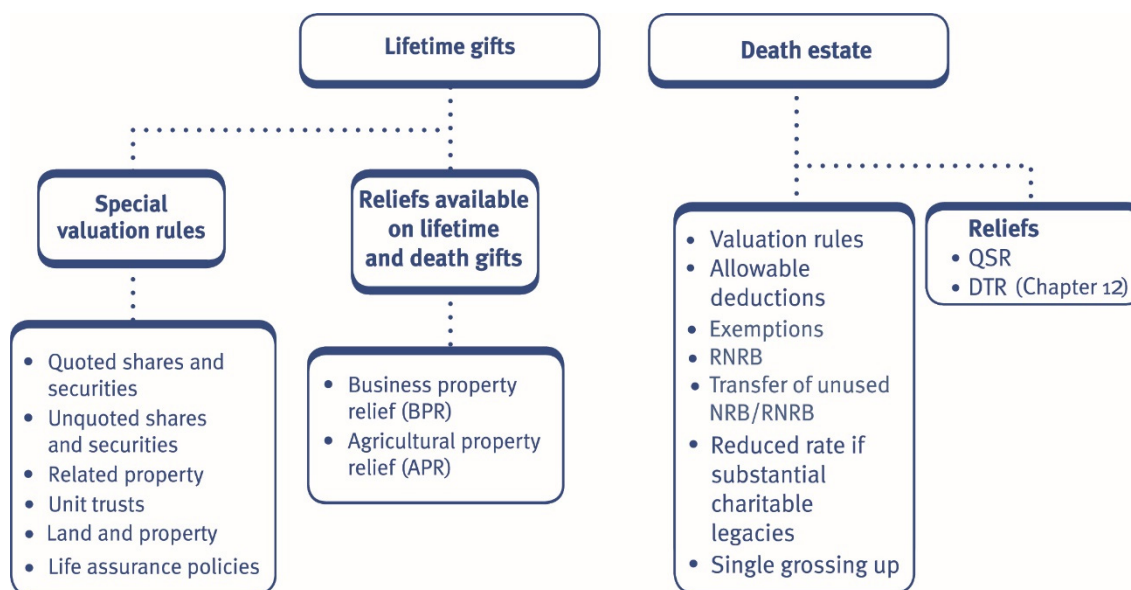
(c) Estate computation

	£
Estate value	664,000
Less: Exempt legacies	
Spouse	(331,000)
	<hr/>
Gross chargeable estate	333,000
	<hr/>
IHT liability on estate	
Gross chargeable estate value	333,000
Less: NRB available	(325,000)
	<hr/>
Taxable amount	8,000
	<hr/>
IHT on death (£8,000 × 40%)	3,200
	<hr/>
Distribution of the estate	£
Cash to spouse	331,000
Residue to son (£333,000 – £3,200)	329,800
IHT on Charbel's legacy to HMRC	3,200
	<hr/>
	664,000
	<hr/>

12 Summary of death estate



13 Chapter summary



Test your understanding answers



Test your understanding 1

Jeremy**Company loan notes**

Capital value = 1/4 up method = $94 + (98 - 94) \times 1/4$

= £95 per £100 of loan notes

Value of £100,000 loan notes:

	£
£100,000 × 95/100	95,000
Add: Next net interest payment	
£100,000 × 6/12 × 10% × 80%	4,000
	<hr/>
Capital value	99,000
	<hr/>



Test your understanding 2

Sultan

Value of 5,000 units = $(5,000 \times £1.25) = £6,250$.



Test your understanding 3

Sara

Before the gift, Sara and her husband own five chairs between them.

After the gift, they own four chairs between them.

Note that the chair owned by the daughter is not related property.

The value of Sara's two chairs before the gift is: £
 $[\£15,000/(\£15,000 + \£25,000)] \times \£60,000 = \£22,500$

The value of Sara's one chair after the gift is:
 $[\£5,000/(\£5,000 + \£25,000)] \times \£40,000 = \£6,667$

The transfer of value is therefore:

	£
Value of estate before transfer	22,500
Less: Value of estate after transfer	(6,667)
	<hr/>
Transfer of value	15,833
	<hr/>

Note that this value is significantly higher than the unrelated value of one chair = £5,000.

For CGT purposes, the MV of the asset gifted is used to start the computation (i.e. MV of one chair = £5,000).



Test your understanding 4

James

	Before the gift No. of shares	After the gift No. of shares
James	8,000	2,000
Wife	2,000	2,000
	<hr/>	<hr/>
	10,000	4,000
	<hr/>	<hr/>
% Holding	50%	20%
Value per share	£7	£4

The value of James' shares before the gift is:

$$(8,000 \times £7) = £56,000$$

The value of James' shares after the gift is:

$$(2,000 \times £4) = £8,000$$

The transfer of value is therefore:

	£
Value of Simons Ltd shares before the gift	56,000
Less: Value of Simons Ltd shares after the gift	(8,000)
	<hr/>
Transfer of value	48,000
	<hr/>



Test your understanding 5

Judeline

- (1) There is no entitlement to BPR as ABC plc is a quoted company and Judeline does not have a controlling interest.
- (2) BPR is available at the rate of 100% as DEF Ltd is an unquoted trading company.
- (3) There is no entitlement to BPR as Judeline is not a partner of the partnership. In this instance, the property is effectively held by Judeline as an investment.
- (4) There is no BPR since GHI plc is a quoted company, and Judeline does not have a controlling interest even when taking account of her husband's shares.
- (5) 100% BPR is given as Green Ltd is an AIM listed trading company.



Test your understanding 6

JKL Ltd

The shares in MNO Ltd have only been held for six months. However, BPR at 100% is available as Marsha has held relevant business property (MNO Ltd shares and JKL Ltd shares) for more than two years out of the last five years.

The amount of BPR will be restricted to £110,000 as it cannot exceed the amount of BPR that would have been given on the original property that was replaced.

Therefore, the gross chargeable amount of Marsha's PET to her sister:

	£
Transfer of value	160,000
Less: BPR	(110,000)
AE – 2023/24	(3,000)
– 2022/23 b/f	(3,000)
	<hr/>
Gross chargeable amount	44,000
	<hr/>

**Test your understanding 7****Eduarda**

31 May 2023 Gift to her niece = PET

	£
Transfer of value	180,000
Less: BPR	
$100\% \times £180,000 \times (£450,000/£500,000)$	(162,000)
ME	(1,000)
AE – 2023/24	(3,000)
– 2022/23 b/f	(3,000)
	<hr/>
Gross chargeable amount	11,000
	<hr/>

**Test your understanding 8****Zac**

	£
Transfer of value – Farming business	1,230,000
– Cash	20,000
	<hr/>
	1,250,000
Less: APR on agricultural value	
$(£600,000 \times 100\%)$	(600,000)
BPR on remaining value	
$(£400,000 + £150,000 + £80,000) \times 100\%$	(630,000)
ME (grandparent to grandchild)	(2,500)
AE – 2023/24	(3,000)
– 2022/23 b/f	(3,000)
	<hr/>
Gross chargeable amount	11,500
	<hr/>

Note: Items such as the development value of the farm, the farm animals, inventory and farming equipment do not qualify for APR.

However, as it is Zac's unincorporated business and he has owned and worked the farm for more than two years, BPR is available.

If the farm was owned by Zac but let to tenants who worked the farm, APR would be available on the agricultural value but BPR would not be available on the remainder.



Test your understanding 9

Tom

Death estate – 30 June 2023

	£	£
House		200,000
Cottage		250,000
Unincorporated business	400,000	
Less: BPR (100%)	(400,000)	
		0
Bank account		75,000
Quoted shares (Note)		100,000
Car		15,000
Less: Allowable expenses – Credit card		(2,000)
– Income tax and CGT		(3,000)
		635,000
Less: Exempt legacy to wife – House		(200,000)
– Quoted shares		(100,000)
– Business		(0)
Gross chargeable estate		335,000
IHT on chargeable estate		
(£335,000 – £216,000 (W)) = £119,000 × 40%		47,600

Note: The quoted shares do not qualify for BPR as it is assumed that Tom does not have a controlling interest in the company.

Always assume that the individual does not have a controlling interest unless the question states otherwise.

Working: Lifetime gift to son

	£
Transfer of value	115,000
Less: AE – 2019/20	(3,000)
– 2018/19 b/f	(3,000)
PET	109,000

No lifetime tax was payable on this gift as it was a PET. At death, the current (2023/24) NRB of £325,000 is applied to the gift. The remaining NRB available for the estate = (£325,000 – £109,000) = £216,000.


Test your understanding 10
Han
Death estate – 1 May 2023

	£	£
Family home		445,000
Quoted shares		145,000
Cash		67,000
		<hr/>
		657,000
Less: Debt due at death		(3,200)
		<hr/>
		653,800
Less: Exempt legacies		
Spouse		(145,000)
Charity		(67,000)
		<hr/>
Gross chargeable estate		441,800
		<hr/>
IHT on chargeable estate:		
Gross chargeable estate		441,800
Less: RNRB		(175,000)
NRB @ date of death – 2023/24	325,000	
Less: GCTs < 7 years before death		
(1.5.2016 to 1.5.2023) (W1)	(304,000)	
	<hr/>	
NRB available		(21,000)
		<hr/>
Taxable amount		245,800
		<hr/>
IHT due on Han's death (£245,800 × 36% (W2))		88,488
		<hr/>

Workings:**(W1) Lifetime gift to son**

	£
Transfer of value	310,000
Less: AEs – 2020/21 and 2019/20 b/f	(6,000)
	<hr/>
PET	304,000
	<hr/>

This gift is a PET and falls below the value of the NRB at death.

No IHT is due on this gift but it reduces the NRB to set against the death estate.

(W2) Rate of tax to use for the death estate

	£
Taxable amount	245,800
Add back: Charitable legacy	67,000
NRB	175,000
	<hr/>
Baseline amount	487,800
	<hr/>
Apply 10% test ($£487,800 \times 10\%$)	48,780
	<hr/>

As the charity legacy of £67,000 is more than £48,780, the reduced rate of 36% can be applied to calculate the tax on the estate.



Test your understanding 11

Wilma

Death estate – 4 October 2023

	£	£
Main residence		628,000
Flat		150,000
Shops (Note 1)		231,250
Villa (\$200,000/10)		20,000
Partnership share (£400,000/2)	200,000	
Less: BPR (100%)	(200,000)	
		0
Shares in ZAM plc (20,000 @ 200p) (Note 2)		40,000
Units in CBA trust (8,000 @ 130p)		10,400
Bank balances		57,850
		1,137,500
Less: Income tax due	(7,500)	
Funeral expenses	(2,000)	
		(9,500)
		1,128,000
Less: Exempt legacies		
Husband	(120,000)	
Political party	(50,000)	
		(170,000)
Gross chargeable estate		958,000
IHT liability on the estate value		
Gross chargeable estate		958,000
Less: RNRB		(175,000)
NRB @ date of death – 2023/24	325,000	
Less: GCTs < 7 years before death (4.10.2016 to 4.10.2023)	(0)	
NRB available		(325,000)
Taxable amount		458,000
IHT due on Wilma's death (£458,000 × 40%)		183,200

IHT liability on the estate

The tax is paid by the executors and is suffered by Joe, who inherits the residue of the estate.

Notes:

- (1) The shops are valued using the related property rules as follows:

$$\frac{\pounds 200,000 (\pounds 50,000 \times 4)}{\pounds 200,000 + \pounds 120,000 (\pounds 60,000 \times 2)} \times \pounds 370,000 = \pounds 231,250$$

- (2) The shares in ZAM plc are valued at the lower of:

- (i) Quarter up method = $198\text{p} + \frac{1}{4} (206\text{p} - 198\text{p}) = 200\text{p}$
- (ii) Average of highest and lowest marked bargains
 $= \frac{1}{2} \times (196\text{p} + 208\text{p}) = 202\text{p}$

**Test your understanding 12****Reem****31 July 2023**

	£
Gross chargeable estate value	340,000
Less: NRB available	(325,000)
	<hr/>
Taxable amount	15,000
	<hr/>
IHT on death ($\pounds 15,000 \times 40\%$)	6,000
Less: QSR (W)	(933)
	<hr/>
IHT payable on Reem's estate	5,067
	<hr/>

Working

$$\text{QSR} = (\pounds 75,000 / \pounds 450,000) \times \pounds 28,000 \times 20\% (\text{Note}) = \pounds 933$$

Note: June 2019 to July 2023 = 4 – 5 years.

IHT: Overseas, administration and tax planning

Chapter learning objectives

Upon completion of this chapter you will be able to:

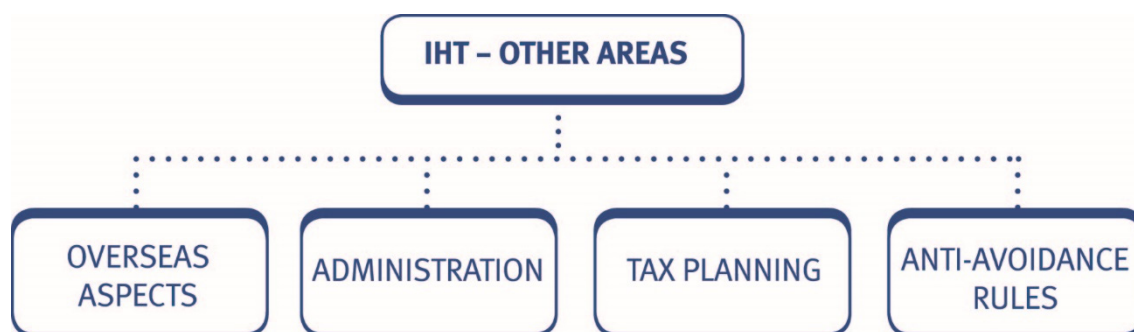
- understand the capital gains tax implications of the variation of wills
- explain the concepts of domicile and deemed domicile and understand the application of these concepts to inheritance tax
- identify and advise on the tax implications of the location of assets
- identify and advise on gifts with reservation of benefit
- advise on the operation of double tax relief for inheritance tax
- advise on the inheritance tax effects and advantages of the variation of wills
- advise on the use of reliefs and exemptions to minimise inheritance tax liabilities
- identify the occasions on which inheritance tax may be paid by instalments
- advise on the due dates, interest and penalties for inheritance tax purposes
- identify and advise on the taxes applicable to a given course of action and their impact
- assess the tax advantages and disadvantages of alternative courses of action

- advise on legitimate tax planning measures, by which the tax liabilities arising from a particular situation or course of action can be mitigated.



PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. Another (PO16) is to ensure that individuals comply with their tax obligations – on time, and in the spirit and letter of the law. Working through this chapter should help you understand how to demonstrate those objectives.



1 Overseas aspects of IHT

For IHT purposes, the individual's domicile status is key to determining the extent to which overseas assets will be liable to IHT.

Domicile and deemed domicile

The definition of domicile for IHT is the same as for income tax and capital gains tax (see Chapter 20).

However, there are **three** situations in which a non-UK domiciled individual can be deemed to be UK domiciled for IHT purposes.

UK domiciled individuals leaving the UK

- An individual who has been domiciled in the UK, moves abroad and makes a permanent home in another country, is deemed to remain UK domiciled for IHT for a further three years after ceasing to be UK domiciled.

Long term residents

- An individual is deemed to be UK domiciled in a tax year if the individual has been UK resident for:
 - 15 of the previous 20 tax years, and
 - at least one of the previous four tax years ending with the tax year of the chargeable transfer.

Formerly domiciled residents

- An individual is deemed domiciled in a tax year if the individual:
 - was born in the UK, and
 - has a UK domicile of origin, and
 - is UK resident in that tax year, and
 - was UK resident for at least one of the two tax years immediately preceding that tax year.

The effect of an individual's domicile status for IHT



Individuals are assessed to IHT as follows:

Domicile status:	Charged to IHT on:
UK domiciled or deemed domiciled in the UK	Transfers of worldwide assets
Non-UK domiciled	Transfers of UK assets only



Test your understanding 1

Thalia has been domiciled in the UK since birth.

On 1 June 2020, she emigrated to France with the intention of remaining there permanently and changed her domicile.

She died on 31 March 2023.

Explain the extent to which Thalia will be liable to IHT.



Test your understanding 2

Luka is domiciled in Germany. He became UK resident on 1 May 2005 and died on 1 March 2024.

Explain the extent to which Luka will be liable to IHT.

Location of assets

UK domiciled individuals are charged to IHT on all assets regardless of the location of the assets. A non-UK domiciled individual is only liable to IHT on UK assets.

It is therefore necessary to be able to identify where in the world an asset is deemed to be located for IHT purposes, as follows:

Type of asset	Location of asset
Land and buildings	Physical location
Registered shares and securities	Place of registration
Chattels	Location at time of transfer
Debts due to the individual	Where the debtor resides at the time of the transfer
Bank accounts	Location of the branch which maintains the account
Life assurance policies	Where the proceeds are payable
Business	Where the business is carried on



Test your understanding 3

Sam has lived in the UK for the last six years, however he is not UK domiciled and is not deemed to be domiciled in the UK. He owns the following property.

- (1) Freehold property situated in the UK.
- (2) Leasehold property situated in the USA.
- (3) Shares in USA Inc., a company quoted and registered on the US stock exchange.
- (4) Antiques situated in Sam's US residence.
- (5) A loan due to Sam by his sister who is resident in the USA. The sister used the loan to buy property situated in the UK.
- (6) A car that was bought in the USA, but is now situated in the UK.
- (7) Bank deposits in sterling with the UK Branch of a US Bank.
- (8) UK government stocks.
- (9) US government stocks.

Explain whether Sam is liable to be charged to IHT if he transferred his property.



Election to be treated as UK domiciled

A non-UK domiciled individual with a UK domiciled spouse or civil partner can elect to be treated as domiciled in the UK for IHT purposes.

The election:

- can be made any time during the non-UK domiciled spouse or civil partner's lifetime (a 'lifetime election') and can apply from any date within the seven years prior to the election
- is irrevocable whilst the electing spouse or civil partner is UK resident, but lapses if that spouse or civil partner becomes non-UK resident for four full consecutive tax years
- can be made within two years of the death (a 'death election') of either:
 - the UK domiciled spouse or civil partner (where the non-UK domiciled spouse or civil partner is still alive), or
 - the non-UK domiciled spouse or civil partner (where the UK domiciled spouse or civil partner has previously died), by the personal representatives

and can specify that it is to take effect from any date within the seven years prior to the deceased's death, but cannot apply before 6 April 2013

- only applies for the purposes of inheritance tax, and does not apply to any other taxes

- may be beneficial where assets of more than £325,000 are transferred to a non-UK domiciled spouse or civil partner, as there would then be no limit to the exempt amount.

However, this advantage must be weighed up against the fact that the non-UK domiciled spouse or civil partner would then in the future be subject to UK IHT on overseas assets, which would otherwise escape tax in the UK.



Test your understanding 4

Andrea, who is UK domiciled, and Lloyd, who is domiciled in Australia, married in June 2013. They have lived in South Wales since the marriage and have one child, Steven.

Andrea died in May 2023 leaving her entire estate consisting of UK assets valued at £950,000 to Lloyd. She had made no lifetime gifts.

Following Andrea's death, Lloyd is considering whether he should make the election to be treated as UK domiciled for IHT purposes. He intends to leave his entire estate to Steven and has made no lifetime gifts.

Lloyd owns UK assets worth £200,000 and overseas property valued at £250,000. His estate does not include any residential properties.

Advise Lloyd as to whether he should make the election.

Valuation of overseas assets

Overseas assets are valued at OMV on the same basis as assets situated in the UK. However, note that:

- where the value is provided in foreign currency it is converted into sterling at the exchange rate in force at the date of death which gives the lowest sterling valuation
- when valuing an overseas property to include in a death estate, additional expenses incurred in
 - administration relating to the overseas property, and
 - expenses relating to the sale of the overseas propertymay be deducted from the open market value of the property up to a maximum of 5% of the market value of the property
- if IHT is payable and overseas tax has been paid, double tax relief (DTR) may be due.



2 Double taxation relief

Double taxation relief (DTR) applies where an asset situated overseas is subject to both UK IHT and tax overseas.



DTR is a **tax credit** against the IHT liability of an estate on the death of the individual which is deducted **after** QSR, if any.

DTR is calculated as follows:

Lower of

- the overseas tax suffered (given in the examination), and
- the UK IHT payable on the overseas asset.

The UK IHT payable on the overseas asset is calculated at the average estate rate (AER) of IHT payable on the gross chargeable estate **after** QSR as follows:

$$\frac{\text{IHT on the estate after QSR}}{\text{Gross chargeable estate value}} \times \text{Value of asset in estate}$$

The value of the overseas asset brought into the estate is the value after deducting any additional expenses incurred in realising or managing the property (which may be subject to a maximum of 5%).



Illustration 1 – QSR and DTR

Pipaluk died on 15 August 2023 leaving an estate valued at £375,000. The estate included a rental property situated overseas valued at £60,000. Overseas IHT of £18,000 was paid on this property. Pipaluk had never lived in the property.

The estate also included a 4% interest in quoted shares that Pipaluk inherited on the death of her mother on 10 November 2020. The shares were the total holding of shares held by her mother on her death.

At the time of her death the shares were worth £50,000, and on Pipaluk's death they were worth £115,000. IHT of £80,000 was paid on a total estate of £400,000 on her mother's death.

Pipaluk had made no lifetime gifts and she left her entire estate to her son.

Calculate the IHT payable as a result of Pipaluk's death.

Solution**15 August 2023**

	£
Gross chargeable estate value	375,000
Less: NRB available	(325,000)
	<hr/>
Taxable amount	50,000
	<hr/>
	£
IHT due on death (£50,000 × 40%)	20,000
Less: QSR (W1)	(6,000)
	<hr/>
	14,000
Less: DTR (W2)	(2,240)
	<hr/>
IHT payable on Pipaluk's estate	11,760
	<hr/>

Workings**(W1) QSR**

$$\text{QSR} = (£80,000/£400,000) \times £50,000 \times 60\% \text{ (Note)} = £6,000$$

Note: The appropriate percentage is 60% as there are between 2 – 3 years from the legacy and Pipaluk's death.

The current value of the quoted shares is irrelevant to the calculation of QSR.

(W2) DTR

The rate of IHT on the estate after QSR is 3.733% (£14,000/£375,000 × 100).

DTR is therefore the lower of:

(i) Overseas tax suffered	£18,000
(ii) UK IHT payable (£60,000 × 3.733%)	£2,240

**Test your understanding 5**

George died on 15 February 2024, leaving the following estate.

A farm in Utopia rented out to tenant farmers	£45,000
Other assets after liabilities valued at	£303,250

The farm was left to his brother and the residue was left to his niece.

Additional costs of administering the Utopian farm were £3,500 and Utopian death duties payable amounted to £6,000.

George had made no lifetime transfers.

Compute the inheritance tax payable, showing clearly the amount payable by George's brother.

3 Payment of IHT



Normal dates of payment

It is the responsibility of the person liable to IHT to inform HMRC of the relevant transfers of value. HMRC will then calculate the amount of IHT due.

IHT is payable as follows:

Transfer	Due Date
CLTs between 6 April and 30 September	30 April in the following year
CLTs between 1 October and 5 April	Six months after the end of the month in which the transfer is made
PETs chargeable as a result of death	Six months after the end of the month of death
Additional tax due on CLTs within seven years before the death	Six months after the end of the month of death
Estate at death	<p>Earlier of</p> <ul style="list-style-type: none"> • six months after the end of the month of death, or • on delivery of the estate accounts to HMRC (unless tax is being paid in instalments, see below). <p>Interest runs from six months after the end of the month of death.</p>



You will have seen the payment due dates when studying IHT in TX. These are still important to remember in ATX as when advising a client, a key piece of information the client is often interested in is when any tax is due.

**Delivery of accounts**

An 'account' must be submitted to HMRC within 12 months of the end of the month of death. This should include all details of the estate.

For any lifetime transfers the account must be delivered within 12 months of the end of the month of transfer.

If an account is submitted late there will be a £100 penalty. A further £100 penalty is charged if the account is between 6 and 12 months late. If the IHT liability was less than £100 the penalty would be equal to the amount outstanding.

If the account is over 12 months late, and there is IHT due, there is a further penalty of up to £3,000. This could exceed the actual IHT liability.

**Penalties for errors**

Penalties for errors are in line with those charged for errors in an income tax return (see Chapter 15).

**Payment by instalments**

IHT on land and buildings, a business or an interest in a business and certain shares can be paid in ten equal annual instalments, starting on the normal due date for payment.

The asset must still be owned by the donee, and if it is sold the whole of the outstanding instalments become payable immediately.

**Payment by instalments – detail**

The tax must arise on any of the following:

- estate at death
- lifetime gifts made within seven years before the death
- lifetime gifts where the donee has agreed to pay the tax arising.

The assets to which the instalment basis applies are:

- land wherever situated
- shares or securities in a company where the transferor controlled the company immediately before the transfer
- shares or securities in an unquoted company where the tax arises on death, and the amount of tax payable on all instalment assets is at least 20% of the total tax payable on the estate

- shares of an unquoted company with a value in excess of £20,000, which represent 10% or more of the nominal value of the company's shares
- a business or an interest in a business.

Note that a business or an interest in a business would usually qualify for 100% BPR – if so, no tax is due. If the transfer did not qualify e.g. the business had not been owned for two years, the instalment option could be considered for any tax due.

4 Comprehensive example

The following example involves a comprehensive death estate computation using the special valuation rules and reliefs.



Test your understanding 6

You have been asked by the chairman of your company for advice on the inheritance tax position on the death of his father, Reg. You ascertain that Reg died on 1 March 2024, and his estate comprised of the following:

- (1) Freehold house and land valued for probate at £630,000. This property was owned jointly by the deceased and his wife (who survived him) as joint tenants.
- (2) Overseas rental property with a sterling equivalent of £30,000, left to his daughter. Additional costs of administering the property were £1,800 and death duties payable overseas amounted to £6,500.
- (3) A property situated in Cornwall valued at £440,000. This property had been Reg's main residence.
- (4) £10,000 8% Corporate bonds valued at 82 – 86p. Interest is payable half yearly on 30 June and 31 December.
- (5) £8,000 6% Treasury stock valued at 72 – 74p ex interest. Interest is payable half yearly on 31 March and 30 September.
- (6) Ordinary shares in Able Ltd, an unquoted trading company, worth £10,000. The shares have been owned for five years. 12% of the company's net assets are investments.
- (7) Bank deposit account £60,635.
- (8) Accrued interest £2,000 (net).
- (9) Personal chattels £10,000.
- (10) Death in service £200,000. The death in service policy is expressed to be for the benefit of the spouse.

Debts and funeral expenses amounted to £2,665.

By his will apart from leaving the overseas property to his daughter, Reg bequeathed legacies of £5,000 to each of two grandchildren, a legacy of £15,000 and the personal chattels to his widow and the residue to his son, your chairman.

Reg had made one lifetime gift of £139,000 cash into a discretionary trust in November 2021. Reg agreed to pay any IHT, if applicable.

Calculate the inheritance tax payable on the estate.

State who should pay the tax and who will suffer the tax.



5 Tax planning

Lifetime giving versus gifting on death

When advising a client of the advantages and disadvantages of lifetime giving versus gifting assets on death in a will, consideration should be given to the relationship between IHT and CGT as set out in the table below.



Exam questions involving the timing of gifts could test several professional skills, such as: your ability to analyse information and evaluate possible reliefs, your communication skills in explaining the tax implications to your client using non-technical language and also your commercial acumen in relation to advising on the most appropriate way to structure such gifts.

	CGT	IHT
Lifetime gift	<ul style="list-style-type: none"> no CGT if asset is an exempt asset chargeable gain/allowable loss arises calculated in normal way using MV of the asset gifted as consideration (see below) gift holdover relief may be available <ul style="list-style-type: none"> applies to gifts of business assets, and gifts of any asset where there is an immediate charge to IHT (i.e. a CLT) 	<ul style="list-style-type: none"> no exempt assets for IHT diminution in value concept applies to value the gift (see below) if CLT – IHT payable during lifetime if PET – no tax payable during lifetime but IHT payable if death within seven years valued at time of gift exemptions available on lifetime gifts BPR/APR available <ul style="list-style-type: none"> lifetime and death taper relief available if live for more than three years after the gift

	<ul style="list-style-type: none"> on the subsequent disposal of the asset by the donee, IHT relief may be available (see below) 	<ul style="list-style-type: none"> residence nil rate band not available on lifetime gifts
Gift on death	<ul style="list-style-type: none"> no CGT to pay on death 	<ul style="list-style-type: none"> asset forms part of death estate IHT payable on the MV of the asset at the date of death unless the asset is <ul style="list-style-type: none"> covered by reliefs (e.g. BPR/APR) or is left to an exempt beneficiary (e.g. spouse or civil partner, charity, qualifying political party) residence nil rate band available on main residence if passed to direct descendants on death no other exemptions available on death estate taper relief not available

Starting point for calculations

It is important to appreciate that for lifetime gifts, the starting point for the computation of IHT and CGT is different.

- For IHT purposes, lifetime transfers are valued according to the **diminution in value** concept (i.e. the amount by which the donor's estate has diminished as a result of the gift) and the 'related property' rules must be taken into account.
- For CGT purposes, the value of a lifetime transfer (i.e. a gift) is the value of the asset actually gifted. The concept of 'related property' does not apply to CGT.
- If the asset gifted is quoted shares, different rules are used to value the shares.



Illustration 2 – Lifetime giving versus gifting assets on death

Snezana owns 100,000 shares (a 10% holding) in WXY Ltd. Snezana's husband owns 50,000 shares in WXY Ltd.

On 31 July 2023 she made a lifetime gift of 50,000 shares in WXY Ltd to her daughter.

The relevant values of WXY Ltd's shares at the time of the gift are:

	£
5%	8
10%	10
15%	13

- Calculate the transfer of value for IHT purposes.**
- Calculate the deemed sale proceeds for CGT purposes.**

Solution

- The transfer of value for IHT purposes will be calculated using the related property valuation rules as follows:

	£
Value of shares held before the transfer (based on a 15% holding) $100,000 \times £13$	1,300,000
Value of shares held after the transfer (based on a 10% holding) $50,000 \times £10$	(500,000)
Transfer of value	<u>800,000</u>

- For CGT purposes, a gift of a 5% shareholding has been made.
The deemed consideration is therefore £400,000 ($50,000 \times £8$).



IHT deduction for CGT

Where an asset is gifted to another individual during the donor's lifetime both IHT and CGT need to be considered.

Where both:

- gift holdover relief is claimed on the gift, and
- IHT is paid in relation to the gift

any IHT paid is allowed as a deduction when calculating the chargeable gain arising on the subsequent disposal of the asset by the donee.



Illustration 3 – Lifetime versus gifting assets on death

On 31 December 2020 Yaz made a gift of business property (not in relation to the disposal of the entire business) worth £341,000 to her daughter Jo. Yaz and Jo made a joint gift holdover relief claim to defer the capital gain of £103,000 arising on the gift.

Assume that the business property did not qualify for BPR and that the IHT annual exemptions have already been used.

Yaz died on 30 April 2023 having made no other lifetime transfers except those to use her annual exemption each year.

Jo sold the business property for £368,000 on 31 August 2023. Jo is a higher rate taxpayer and makes no other disposals in the tax year 2023/24.

Calculate the CGT liability that will arise upon Jo's disposal of the business property on 31 August 2023.

Solution

When calculating her CGT liability, Jo will be able to deduct the IHT payable as a result of the PET becoming chargeable. It is therefore necessary to compute the IHT payable on the PET first.

IHT payable – during lifetime

31 December 2020 – PET	£
Transfer of value	341,000
Less: BPR (not applicable per question)	(0)
Less: AE (not available per question)	(0)
	<hr/>
Potentially exempt	341,000
	<hr/>
Lifetime IHT due (PET)	0
	<hr/>

IHT payable – on death

	£
Gross chargeable amount (above)	341,000
NRB available at death	(325,000)
	<hr/>
Taxable amount	16,000
	<hr/>
IHT due on death ($£16,000 \times 40\%$)	6,400
Less: Taper relief (31.12.2020 to 30.4.2023) (< 3 years before death)	(0)
Less: IHT paid in lifetime (PET)	(0)
	<hr/>
IHT payable on death	6,400
	<hr/>

CGT liability – Disposal of asset gifted – 31 August 2023

	£	£
Sale proceeds		368,000
Base cost of asset to Jo:		
MV at date of gift	341,000	
Less: Gain held over	(103,000)	
	<hr/>	(238,000)
		<hr/>
		130,000
Less: IHT paid on PET		(6,400)
		<hr/>
Chargeable gain		123,600
Less: AEA		(6,000)
		<hr/>
Taxable gain		117,600
		<hr/>
CGT payable by Jo ($£117,600 \times 20\%$)		23,520
		<hr/>

IHT planning

It is important for an individual to plan lifetime gifts to be tax efficient and to make a will so that the individual's estate is distributed in a tax efficient way.

There are a number of tax planning measures that can reduce an individual's liability to IHT which can be divided into three areas:

- lifetime tax planning
- death estate planning
- married couples and civil partners planning.

The overall objectives of all IHT tax planning measures are:

- to minimise the amount of tax payable
- to maximise the inheritance of the next generation.



IHT planning

Lifetime tax planning

IHT planning during an individual's lifetime involves making gifts of wealth as early as possible.

Advantages of lifetime gifts

- If the gift is a PET, no IHT will be payable if the donor survives seven years.
- If the gift is a CLT the tax is calculated at 20% and no additional IHT will be payable on death if the donor survives seven years.
- If the donor does not survive seven years, taper relief will be available after three years.
- A lifetime gift is valued at the time of the gift and the value is 'frozen'. This locks the value of an appreciating asset, so any increase in value up to the date of death will not be taxed.
- If the value of the asset decreases, fall in value relief may be available to reduce the chargeable amount on death.
- Exemptions such as normal gifts out of income, small gifts, marriage and AEs may reduce or eliminate the value of a lifetime gift.
- However, remember the CGT implications:
 - CGT may be payable on lifetime gifts of chargeable assets, but
 - CGT will not be payable on assets held at the date of death.
- An individual should therefore be advised to make lifetime gifts of assets that are:
 - appreciating in value, and
 - will not generate a significant liability to CGT.

For example, gift assets that are exempt from CGT or assets that are deferred or exempted by available CGT reliefs.
- Note however that there is no IHT saving in gifting assets that qualify for BPR or APR at 100%.

Estate planning

An individual should be advised to draft a tax efficient will ensuring that:

- the NRB/RNRB is fully utilised, and
- unnecessary charges to IHT will not be incurred on death.

Skipping a generation

Rather than leaving property directly to children, it may be more advantageous to miss out a generation and to leave the property to grandchildren instead.

There will be no immediate saving of IHT, but a charge to IHT on the death of the children will be avoided.

Such planning is particularly relevant if the children already have sufficient property in their own right.

The income tax benefits of this arrangement may also be attractive:

- If a parent sets up a source of income for a child, the parent is assessed on the income generated unless the amount is below the de minimis threshold of £100 (Chapter 16).
- However, if the grandparents set up the source of income, the income is assessed on the child regardless of the amount.

Married couples and civil partners

The following points should be considered by spouses and civil partners:

- Ensure elections are made to:
 - transfer unused NRB/RNRB if a widow or widower (Chapter 10)
 - be treated as UK domiciled if beneficial (section 1).
- Choose carefully which assets to gift.
- Make use of a deed of variation to minimise IHT on death.



Choice of assets to gift

Advice that could be given to married couples or civil partnerships is:

- Where the couple owns assets that qualify for BPR and/or APR these assets should not be left to the other spouse or civil partner. This is because the legacy would be covered by the inter-spouse exemption and the benefit of BPR/APR would be wasted.
- Therefore BPR and APR assets should be left to non-exempt beneficiaries and other assets left to the spouse or civil partner.

As a result, the benefit of both the relief and inter-spouse exemption will be available to reduce the value of the chargeable estate.



Illustration 4 – IHT planning

Joan is 67 years old, and was widowed on the death of her husband on 21 June 2008. She has six grandchildren.

The husband had a chargeable estate valued at £800,000, and this was left entirely to Joan, he had made no lifetime transfers.

Joan now has an estate valued at £1,050,000, which will pass to her two children when she dies. £500,000 of this relates to the family home. Joan's children are both quite wealthy, and are concerned about the IHT liability that will arise upon Joan's death. Joan had made no lifetime transfers.

You are to advise Joan and her children of tax planning measures that they could take in order to minimise the impact of IHT.

The NRB for 2008/09 was £312,000.

Assume the current rate of NRB will apply when Joan dies.

Solution

Husband's death

On Joan's husband's death:

- the transfer to Joan is an exempt transfer
- no IHT is due on his estate, and
- therefore, none of his NRB/RNRB was utilised (i.e. 100% unutilised).

Joan – Death estate

	£
Gross chargeable estate	1,050,000
Less: RNRB at Joan's death	(175,000)
Less: RNRB transferred from her husband (£175,000 × 100%)	(175,000)
Less: NRB at Joan's death	(325,000)
Less: NRB transferred from her husband (Note) (£325,000 × 100%)	(325,000)
	<hr/>
Taxable amount	50,000
	<hr/>
IHT payable on death (£50,000 × 40%)	20,000
	<hr/>

This IHT is paid by the executor, borne by Joan's children.

Note:

- Although the NRB available on Joan's husband's death in 2008/09 was only £312,000, the amount unused was 100% of the NRB. This percentage is applied to the current NRB of £325,000 to calculate the amount that can be transferred.
- Joan's executors must claim the transferred NRB on the submission of the IHT return within two years from her death.

Advice:

- Since Joan's children are already wealthy, it may be more beneficial for Joan to leave her estate to her grandchildren (possibly via use of a trust).

Although this will not save IHT on Joan's death estate, by skipping a generation, IHT on the same wealth will not be due until transfers are made by the grandchildren.

The RNRB will still be available if Joan leaves the family home to her grandchildren, as they are still direct descendants.

- If Joan dies without considering the above, her children could alter Joan's will by a deed of variation within two years from Joan's death (see below).
- Joan should also consider making lifetime gifts to her grandchildren to utilise her AEs and to benefit from the advantages of making PETs.



Deed of variation

It is possible to change the terms of an individual's will after the individual's death by entering into a deed of variation (also known as a deed of family arrangement).

In practice, the main reason for entering into a deed of variation is to redistribute the deceased's estate on a fairer basis. However, a deed of variation can also be used as an effective tax planning tool for IHT and CGT purposes.

Changes can be made to make the provisions of a will more tax efficient in the following situations:

- Where an estate has been left to children who already have sufficient property of their own. Part of the estate could be diverted to grandchildren, thus missing out a generation and therefore bypassing a potential charge to IHT on the death of the children.
- The family home could be diverted to direct descendants (children or grandchildren) to take advantage of the residence nil rate band.
- Amounts left to charity could be increased to 10% or more of the 'baseline' estate to allow the rest of the estate to benefit from the 36% reduced rate of inheritance tax.

However, the revised terms of a will under a deed of variation will only be effective for tax purposes provided the following conditions are satisfied.

The deed must:

- be in writing and signed by all beneficiaries that are affected by the deed
- not be made for any consideration
- be executed within two years of death
- state that it is intended to be effective for tax (IHT and/or CGT) purposes.

Note that without a statement saying the variation is effective for CGT purposes, a transfer will be deemed to take place at market value between the person who first inherited the asset and the person who will subsequently receive it. If there has been an increase in value since the death then this will give rise to a chargeable gain at this point in time.

If the gain arising is covered by the AEA and/or capital losses then it may be advantageous to omit the statement making the variation effective for CGT. If this is not the case then the executors should ensure such a statement is included.



Test your understanding 7

Faisal died on 8 August 2023 leaving his entire estate to his son. The estate is valued at £500,000 after deducting exemptions and reliefs, including a donation to charity of £18,000.

Faisal had made no lifetime gifts and did not own any residential property.

- (a) **Assuming that a deed of variation is made after Faisal's death, calculate the minimum increase in the donation to charity that is required in order that Faisal's estate qualifies for the reduced rate of IHT.**
- (b) **Calculate the net increase in the estate available for Faisal's son as a result of making this increased donation.**



6 Anti avoidance rules: gifts with reservation

A 'gift with reservation of benefit' (GWR) is a lifetime gift where:

- the legal ownership of an asset is transferred, but
- the donor retains some benefit in the asset gifted.

Examples of a GWR include:

- the gift of a house, but the donor continues to live in it
- the gift of shares, but the donor retains the right to future dividends
- the gift of assets into a discretionary trust, but the donor is a potential beneficiary of the trust fund.

Special anti-avoidance rules apply to a GWR to ensure that these gifts do not escape from an IHT charge.

The treatment of GWR

When an asset is gifted but the donor retains the right to use it without payment of full rent, it falls into the GWR rules as follows:

Reservation still in place when donor dies	Reservation lifted before donor's death
(1) Original gift = GWR = PET or CLT @ MV of asset on date of gift	(1) Original gift = GWR = PET or CLT @ MV of asset on date of gift
(2) On death of donor: (donor still uses asset at date of death) = Asset put in donor's estate @ MV on date of death	(2) When reservation lifted: (donor no longer uses asset) = Deemed PET at that time @ MV of asset on date reservation lifted
A GWR therefore potentially gives rise to a double charge to IHT However, HMRC has the right to charge: the highest tax liability arising from event (1) or (2) (known as double charges relief)	

Usually, including the asset in the estate or treating as a PET when the reservation is lifted gives the higher IHT charge. This is because capital assets normally appreciate in value and no annual exemptions are available in the death estate or against the deemed PET.

Any tax arising is payable by the legal owner of the asset (i.e. the donee).

If the gift with reservation is a residential property that the donor lived in, the residence nil rate band will be available where the property is included in the deceased's estate.



Illustration 5 – Gift with reservation

Priya gave her house to her son Sushil on 1 April 2018 when it was worth £360,000. She had made no previous lifetime gifts.

Priya continued to live in the house and paid no rent to Sushil.

Priya died on 1 January 2024 leaving her estate of £700,000 (excluding the house) to Sushil. At this date the house was worth £500,000.

Calculate the IHT payable on Priya's death.

Solution

The transfer of the house is a gift with reservation of benefit.

(1) Treat gift as a PET

	£	£
1 April 2018 – PET		
Transfer of value		360,000
Less: Annual exemption		
Current year – 2017/18		(3,000)
Previous year – 2016/17		(3,000)
		<hr/>
Gross chargeable amount		354,000
NRB @ date of death – 2023/24	325,000	
Less: GCT < 7 years before gift (1.4.2011 to 1.4.2018)	(0)	
	<hr/>	
NRB available		(325,000)
		<hr/>
Taxable amount		29,000
		<hr/>
IHT payable @ 40%		11,600
Less: Taper relief (1.4.2018 to 1.1.2024) (5 – 6 years) (60%)		(6,960)
		<hr/>
IHT payable on death		4,640
		<hr/>

1 January 2024 – Death estate	£	£
Gross chargeable estate value		700,000
NRB @ date of death	325,000	
Less: GCTs < 7 years before death (1.1.2017 to 1.1.2024)	(354,000)	
	<hr/>	
NRB available		0
		<hr/>
Taxable amount		700,000
		<hr/>
IHT payable @ 40%		280,000
		<hr/>
Total IHT payable (£4,640 + £280,000)		284,640
		<hr/>

(2) **Treat gift as part of death estate**

1 January 2024 – Death estate	£	£
Gross chargeable estate value (£700,000 + £500,000)		1,200,000
Less: RNRB		(175,000)
NRB @ date of death – 2023/24	325,000	
Less: GCTs < 7 years before death (1.1.2017 to 1.1.2024)	(0)	
	<hr/>	
NRB available		(325,000)
		<hr/>
Taxable amount		700,000
		<hr/>
IHT payable @ 40%		280,000
		<hr/>

The higher amount of £284,640 will be chargeable on Priya's death.



Exceptions to the GWR rules

The following gifts will not be treated as a GWR.

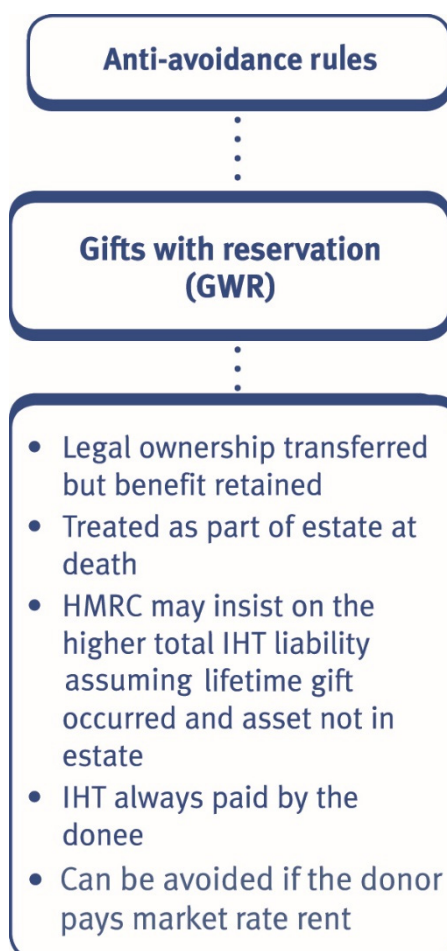
- Where full consideration is paid for the benefit derived from the use of the property.

For example, where a house has been given away but the donor still lives in it, the payment of a commercial rent for the benefit of living in the house will avoid the GWR rules. Rent below the commercial rate will not except the transaction from the rules.

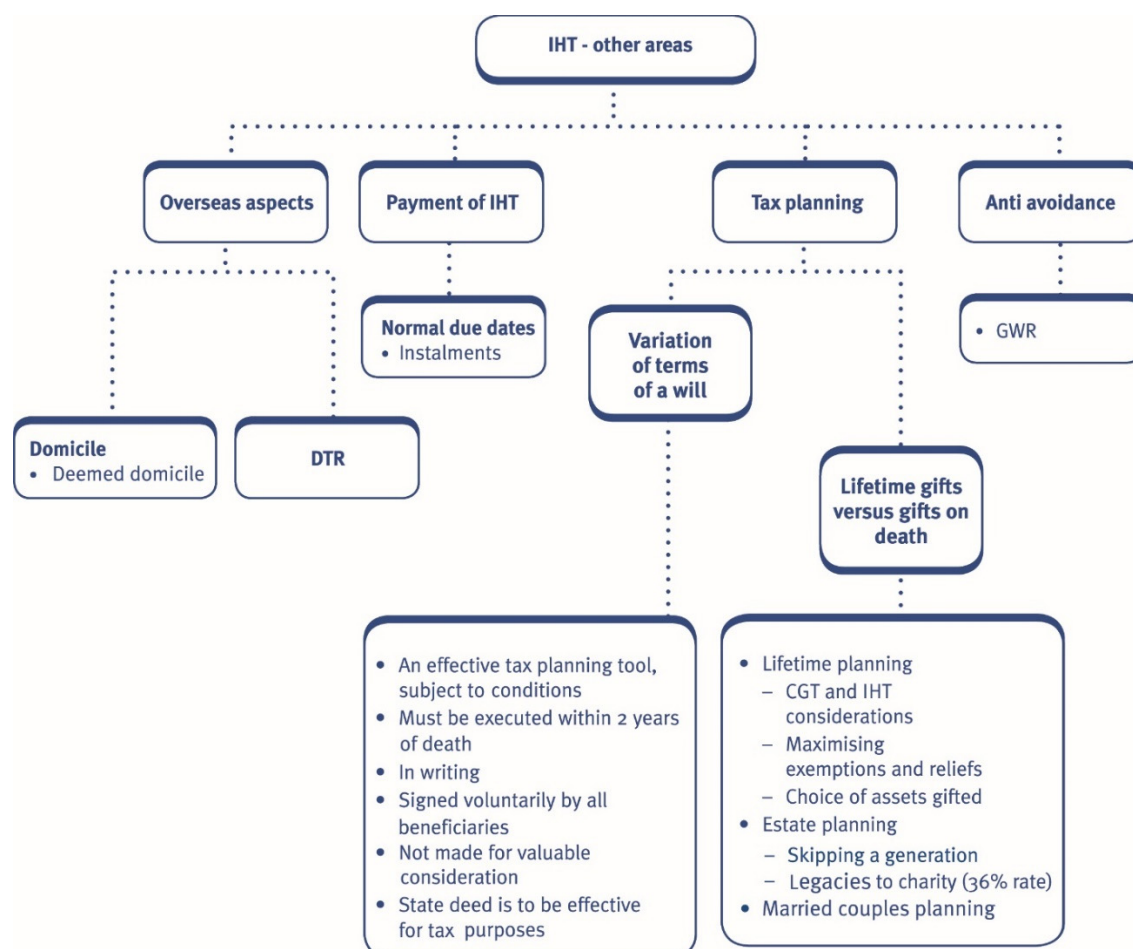
- Where the circumstances of the donor have changed in a way that was not foreseen at the time of the gift.

This situation would be applicable where a house has been given away and the donor moves out of the house. Then, at a later date, the donor becomes ill. If the donor then returns to the house to stay with family because the donor needs to be cared for, then this will not fall under the GWR rules.

7 Summary of anti-avoidance rules



8 Chapter summary



Test your understanding answers



Test your understanding 1

Thalia

Thalia ceased to be domiciled in the UK on 1 June 2020. For IHT purposes, she is deemed to be UK domiciled for a further three years until 31 May 2023.

As her death occurred before this date, she will be liable to UK IHT on her worldwide assets.



Test your understanding 2

Luka

Luka died in 2023/24 and was resident in the UK for 18 tax years before that tax year (2005/06 to 2022/23 inclusive).

As he was resident for at least 15 of the previous 20 tax years, he is therefore deemed to be domiciled in the UK, and will be liable to UK IHT on his worldwide assets.



Test your understanding 3

Sam

Sam is a non-UK domiciled individual and therefore he will only be chargeable to IHT on his assets located in the UK.

- (1) The freehold property is situated in the UK and so is a chargeable asset for IHT.
- (2) The leasehold property situated in the USA is not in the UK and therefore not a chargeable asset.
- (3) The 20,000 shares in USA Inc. are registered in the US and therefore not a chargeable asset to Sam.
- (4) The antiques are in the US residence, so they are not chargeable to IHT at present. If Sam should bring them to the UK, then this would change their location for IHT to the UK.
- (5) As Sam's sister lives in the USA, this is not an asset located in the UK but the USA. Therefore it is not a chargeable asset. The fact that the sister used the loan to buy property situated in the UK is irrelevant.

- (6) The car is now a UK located asset and therefore a chargeable asset.
- (7) Bank deposits in sterling with the UK branch of a US bank – located in the UK therefore chargeable.
- (8) The place of registration of the UK government stocks would have been the UK which makes this also a chargeable asset.
- (9) The US government stocks would have been registered in the US, which makes them an overseas asset and therefore not chargeable.



Test your understanding 4

Andrea and Lloyd

	If no election made		If election made	
	£	£	£	£
On Andrea's death (UK domiciled)				
Estate value		950,000		950,000
Less: Inter-spouse exemption (Note 1)		(325,000)		(950,000)
		<hr/>		<hr/>
Gross chargeable estate		625,000		0
				<hr/>
NRB available	325,000			
GCTs in previous 7 years	0			
	<hr/>	(325,000)		
		<hr/>		
Taxable estate		300,000		
		<hr/>		
IHT payable @ 40%		120,000		0
		<hr/>		<hr/>

On Lloyd's death (UK domiciled)	£	£	£	£
UK assets:				
Owned personally		200,000		200,000
Inherited from Andrea (£950,000 – £120,000)		830,000		950,000
Overseas property (Note 2)		0		250,000
		<hr/>		<hr/>
Gross chargeable estate		1,030,000		1,400,000
		<hr/>		<hr/>
NRB available (Note 3)	325,000		650,000	
GCTs in previous 7 years	(0)		(0)	
	<hr/>	(325,000)	<hr/>	(650,000)
		<hr/>		<hr/>
Taxable estate		705,000		750,000
		<hr/>		<hr/>
IHT payable @ 40%		282,000		300,000
		<hr/>		<hr/>
Total IHT payable		402,000		300,000
		<hr/>		<hr/>

Notes

- (1) If no election is made the inter-spouse exemption is limited to £325,000, whereas with the election it is unlimited.
- (2) The overseas property is only subject to UK IHT if Lloyd elects to become UK domiciled.
- (3) Andrea's unused NRB can be transferred to Lloyd. If no election is made, all of Andrea's NRB is used on her death.

Advice:

Given the situation at the moment, it would be beneficial for Lloyd to make the election to be treated as UK domiciled in these circumstances.

However, the short term benefit of saving tax on the first death may not be ultimately beneficial if the overseas property increases significantly in value and has to be included in Lloyd's estate on death.

The decision must be taken carefully, and thankfully Lloyd can apply the election from any date within seven years prior to making the election, therefore he can leave the decision for up to seven years and back date its application.

Note that if Lloyd remains resident in the UK for more than six years he will be deemed to be UK domiciled for IHT purposes as he will have been resident in the UK for at least 15 out of the previous 20 tax years.



Test your understanding 5

George

Estate computation

	£
Farm in Utopia (Note below)	45,000
Less: Administration expenses (£3,500 but restrict to 5% of open market value i.e. £45,000)	(2,250)
	<hr/> 42,750
Other assets less liabilities	303,250
	<hr/> 346,000
Gross chargeable estate	<hr/>

IHT liability on the estate value

	£
Gross chargeable estate value	346,000
Less: NRB available	(325,000)
	<hr/> 21,000
Taxable amount	<hr/>
	£
IHT on death (£21,000 × 40%)	8,400
Less: QSR	(0)
	<hr/> 8,400
IHT payable after QSR	8,400
(Estate rate = (£8,400/£346,000) × 100 = 2.428%)	
Less: DTR (W)	(1,038)
	<hr/> 7,362
IHT payable on George's estate	<hr/>

Allocation of the IHT liability on the estate

IHT on:	£	£	Tax suffered by:
Overseas property	1,038		
Less: DTR	(1,038)		
	<hr/>	0	G's brother
Other net assets (£303,250 × 2.428%)		7,362	G's niece
		<hr/>	
		7,362	
		<hr/>	

Working: DTR

DTR is the lower of:

(a) Overseas death duties suffered	£6,000
(b) UK IHT attributable to overseas property (2.428% × £42,750)	£1,038

Note:

- APR is not available because the land is not situated in the UK, the EEA, the Channel Islands or the Isle of Man.
- BPR is also not available because the farm is a tenanted farm, which is an investment asset.



Test your understanding 6

Reg

Chargeable estate computation

	£	£
Freehold house ($50\% \times £630,000$)	315,000	
Less: Spouse exemption	(315,000)	
	<hr/>	0
Overseas property	30,000	
Less: Administration expenses restricted to ($5\% \times £30,000$)	(1,500)	
	<hr/>	28,500
Main residence in Cornwall		440,000
Corporate Bonds [$10,000 \times (82p + 1/4 \times (86p - 82p))$]		8,300
Treasury stock [$8,000 \times (72p + 1/4 \times (74p - 72p))$]	5,800	
Plus: interest ($6\% \times £8,000 \times 6/12$)	240	
	<hr/>	6,040
Shares in Able Ltd	10,000	
Less: BPR ($100\% \times £10,000 \times 88\%$)	(8,800)	
	<hr/>	1,200
Bank account (including accrued interest)		62,635
Chattels		10,000
Death in service		200,000
Less: Funeral expenses		(2,665)
		<hr/>
		754,010
Less: Specific spouse legacies		
Chattels		(10,000)
Cash		(15,000)
Death in service policy		(200,000)
		<hr/>
Gross chargeable estate		529,010
		<hr/>

IHT liability on the estate

	£
Gross chargeable estate value	529,010
Less: RNRB available	(175,000)
Less: NRB available (W)	(192,000)
	<hr/>
Taxable amount	162,010
	<hr/>
IHT on gross chargeable estate (£162,010 × 40%)	64,804
Less: QSR	(0)
	<hr/>
IHT after QSR	64,804
AER = (£64,804/£529,010) × 100 = 12.250%	
Less: DTR = Lower of:	
(1) Overseas tax suffered	6,500
(2) UK IHT on overseas asset (£28,500 × 12.250%)	3,491
	(3,491)
	<hr/>
IHT payable on estate	61,313
	<hr/>

Working: NRB available

	£
NRB	325,000
Less: Lifetime CLT in previous 7 years (£139,000 – £3,000 (2021/22) – £3,000 (2020/21))	(133,000)
	<hr/>
NRB available	192,000
	<hr/>

IHT payment

The IHT will be payable by the executors of the estate.

IHT suffered

The IHT on the overseas property will be recovered from the daughter.

The balance of the IHT will be taken from the residue of the estate, and will effectively be suffered by the son (i.e. residuary legatee).

No tax will be suffered by the grandchildren (specific legatee) or the widow (exempt legatee).



Test your understanding 7

Faisal

(a) Increased charitable donation to charity required

	£
Net estate after charitable legacy	500,000
Less: NRB available	(325,000)
	<hr/>
Taxable estate	175,000
Add: Charitable legacy	18,000
	<hr/>
Baseline amount	193,000
	<hr/>
10% of 'baseline amount' (£193,000 × 10%)	19,300
	<hr/>

In order to benefit from the reduced rate of 36%, the donation to charity must be increased by £1,300 (£19,300 – £18,000).

(b) Net increase in the estate available for Faisal's son

	£	£
Cost of extra charitable donation (part (a))		(1,300)
IHT on original taxable estate (without extra charitable donation) (40% × £175,000)	70,000	
IHT on revised taxable estate (with extra charitable donation) (36% × (£175,000 – £1,300))	(62,532)	
	<hr/>	
Reduction in IHT liability on estate		7,468
		<hr/>
Net increase in estate for Faisal's son		6,168
		<hr/>

The taxation of trusts

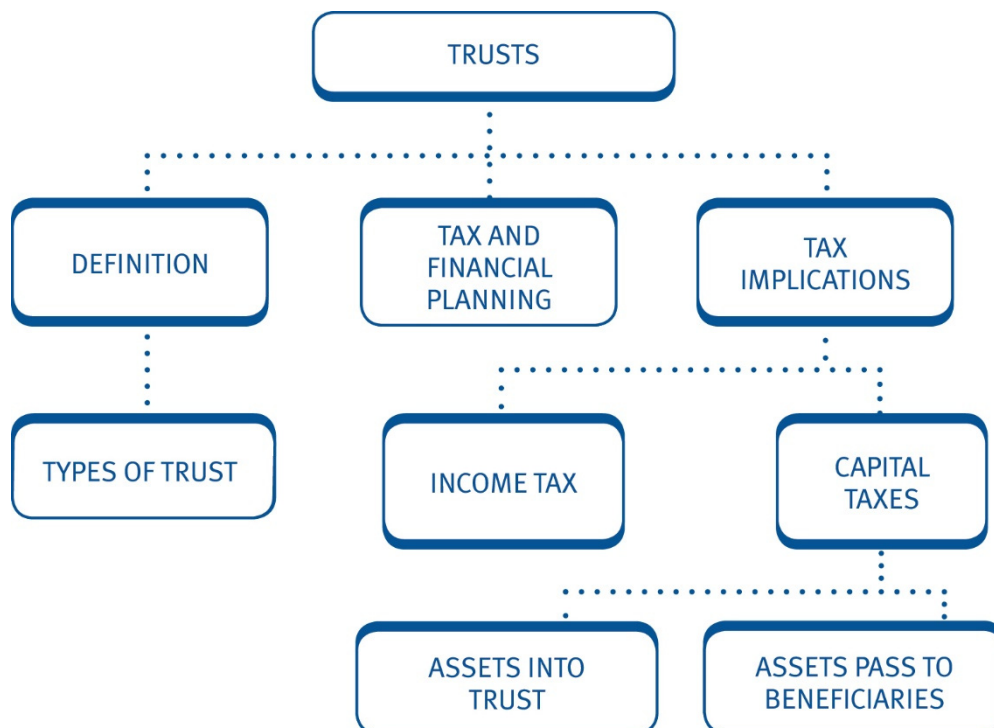
Chapter learning objectives

Upon completion of this chapter you will be able to:

- understand the income tax position of trust beneficiaries
- advise on the capital gains tax implications of transfers of property into trust
- advise on the capital gains tax implications of property passing absolutely from a trust to a beneficiary
- define a trust
- distinguish between different types of trust
- advise on the inheritance tax implications of transfers of property into trust
- advise on the inheritance tax implications of property passing absolutely from a trust to a beneficiary
- identify the occasions on which inheritance tax is payable by trustees
- advise on the use of reliefs and exemptions to minimise inheritance tax liabilities.



One of the PER performance objectives (PO15) includes being able to explain the basis of tax calculations – and interpret the effect of current legislation and case law. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

Due to the complexity of the taxation of trusts, the ACCA has summarised the requirements in relation to trusts for the ATX exam and has excluded many aspects from the syllabus.

This chapter therefore just concentrates on the knowledge required by the ATX examining team.



You may recall encountering trusts when studying IHT in TX. At this level you are now required to understand more than just the IHT implications of setting up a trust.

A summary of the key topics that are examinable is as follows:

- Definition of a trust.
- Knowledge of some of the key types of trust (detailed knowledge of many specific trusts is excluded).
- An understanding of the income tax position of trust beneficiaries (Chapter 16).
- An overview of the income tax consequences of a trust on the trustees (but not calculations of the income tax payable by the trustees).
- Knowledge of the IHT and CGT consequences of transfers into and out of certain UK trusts and charges arising whilst assets are in a trust (but not the calculation of taxes payable by the trustees while the assets are in the trust).

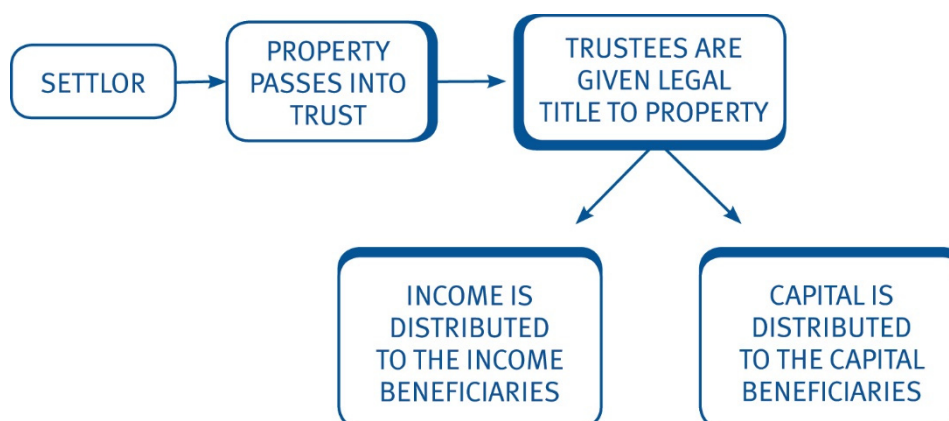
1 The nature of a trust



A trust is an arrangement where:

- property (known as the trust assets or settled property)
- is transferred by a person (known as the settlor)
- to the trustees
- to be held for the benefit of one or more specified persons (known as the beneficiaries)
- on specified terms in the trust deed.

The trust must have more than one trustee and often in practice the settlor's lawyer or accountant will act as one of the trustees.



A trust (sometimes referred to as a settlement) can be created:

- during the settlor's lifetime, or
- on death under the provisions of the settlor's will, or
- following an individual's death under a deed of variation.

If the trust is a lifetime trust, the settlor can be a trustee and/or beneficiary of the trust.

The trust deed sets out the trustee's powers and duties.

The financial planning benefits of a trust arrangement

Trusts are useful arrangements as they allow an individual (the settlor) to give away the benefit arising from the ownership of property to others (the beneficiaries of the trust), whilst retaining some control over the property (as one of the trustees).

The trustees are the legal owners of the property, acting in a representative capacity in the best interests of the beneficiaries.

Separating the beneficial and legal ownership of assets provides financial planning benefits in setting up a trust which include the ability to:

- provide an income from the assets for one group of beneficiaries while preserving and protecting the capital for others
- provide a means for an older generation to protect and make financial provisions for the next generation, particularly where there are young children involved or it is thought that a recipient is financially imprudent
- transfer the benefits of owning property to minors while leaving the control over the assets, together with the responsibilities of managing and maintaining them, with the trustees.

2 Types of trust

There are two main types of trust examinable at ATX:

- Discretionary trusts, and
- Interest in possession trusts (also known as life interest trusts).

Discretionary trusts



A discretionary trust is a flexible settlement where

- the beneficiaries have no legal right to benefit from the income or capital of the trust
- any distribution of income or capital out of the trust is at the complete discretion of the trustees.

The trustees can determine how to meet the needs of the beneficiaries as and when they arise.

In a typical discretionary trust the trustees may have power to decide:

- whether or not trust income is to be accumulated or distributed
- how the trust assets are managed and invested to generate income and capital growth
- how the trust income and the capital of the trust is to be shared amongst different beneficiaries.



Illustration 1 – Discretionary trust

Imran owns a portfolio of shares and transfers them to a discretionary trust for the benefit of his grandchildren.

The trust is set up as follows:

Settlor:	Imran
Trustees:	Imran and Khalid (Imran's son)
Beneficiaries:	Imran's grandchildren
Trust property:	200,000 shares in ABC plc
Income:	Income may be accumulated for up to 20 years from the date of the trust settlement. Subject to the trustees' power to accumulate, the trustees shall each financial year distribute the income of the trust fund to the beneficiaries, and the trustees in their absolute discretion shall determine the proportion or amount of the income for that financial year to be distributed to the beneficiaries or any one or more of them to the exclusion of the others.
Capital:	The trustees may advance the capital of the trust to a beneficiary at any time, and shall have absolute discretion as to the proportion of the capital of the trust to be distributed to any such beneficiary.

Interest in possession trusts



An interest in possession (IIP) trust exists where:

- a beneficiary has an interest in the assets of the trust.

An IIP can be the legal right:

- to receive income generated by the trust assets, and/or
- to use a trust asset or live in a property owned by the trust.

The beneficiary who receives the right to income or use of an asset under an IIP is known as the 'life tenant' of the trust. The life tenant is said to have a 'life interest' in the trust.

The beneficiary who receives the capital assets in the trust when the life interest comes to an end is known as the remainderman.

The remainderman is said to have a 'reversionary interest' in the trust assets as the assets will only revert to the remainderman when the trust comes to an end.

IIP trusts are commonly used in a will where one spouse or civil partner dies and there is a surviving spouse or civil partner and children. The surviving spouse or civil partner is usually named as the life tenant and is entitled to the income generated by the assets (and possibly the right to live in the family home until death), but does not have access to the actual capital assets.

The children are usually the remaindermen and will receive the capital assets on the death of the surviving spouse or civil partner.

This form of trust is a popular arrangement to protect the capital assets for the benefit of the children where, for example, the spouse or civil partner remarries or registers a new civil partnership. The capital will eventually be transferred to the children of the first marriage or civil partnership and not to the new partner or the new partner's family.



Illustration 2 – Interest in possession trust

Felicity is married with two children, and is writing her will. Her main assets are a house and some cash deposits. Felicity would like to provide for her husband, Malik, but wants to ensure that the capital value of her estate is eventually passed to her children, Olivia and Joe.

Felicity could set up an IIP trust with an immediate post-death interest for Malik via her will.

The trust is set up as follows:

Settlor: Felicity

Trustees: Michael (Felicity's brother) and Selina (solicitor)

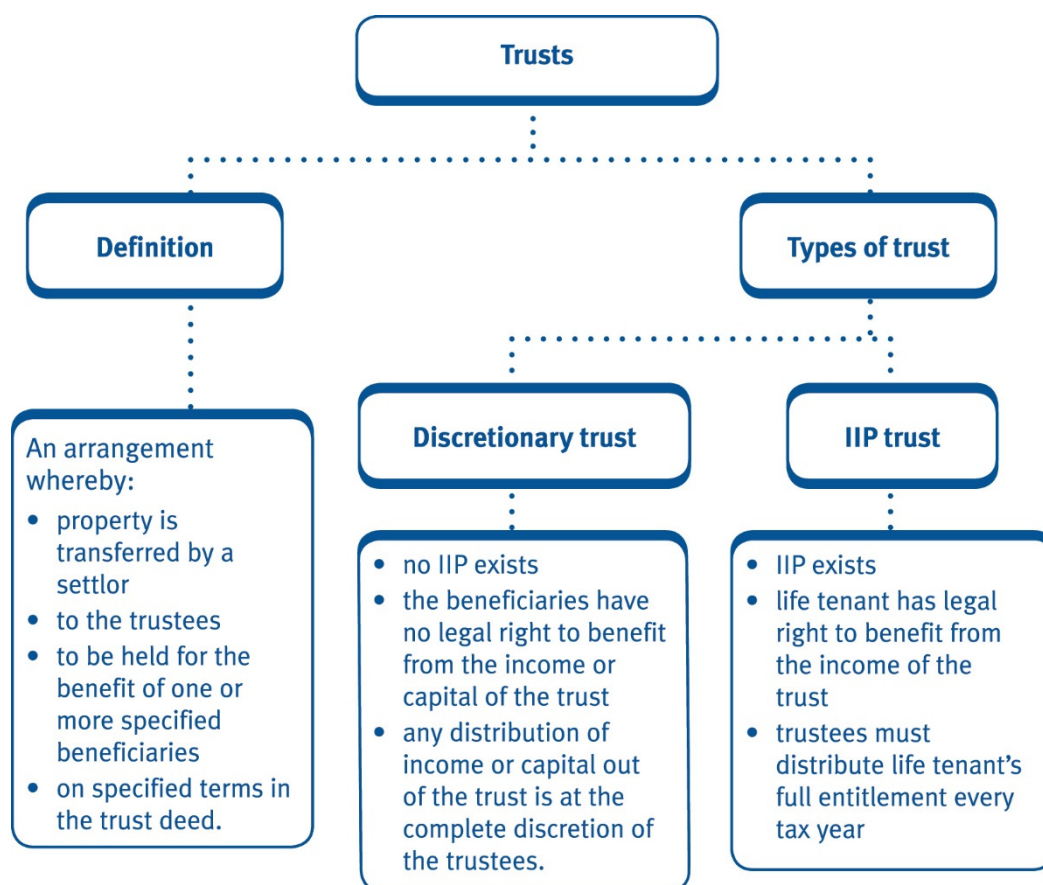
Beneficiaries: Malik (life tenant), Olivia and Joe (remaindermen)

Trust property: House and £350,000 cash

Income: Payable to Malik during his lifetime

Capital: To be advanced to Olivia and Joe on the death of Malik

Summary



3 Income tax and trusts

The trust is a separate legal entity for income tax purposes. The body of trustees is a separate taxable person.

The trustees are subject to income tax on the income arising in respect of trust assets each tax year and they distribute income to the beneficiaries.

An understanding of the way in which trust income is taxed is required, however, the calculation of IT payable by the trustees is not examinable.



The taxation of the trust income operates as follows:

- the trustees account for income tax on the receipt of income by the trust each tax year under self-assessment
- trustees are taxed at different rates depending on the type of trust
- trustees distribute income to the beneficiaries according to the terms of the trust.

Interest in possession trusts

- all of the trust income must be distributed to the life tenant of an IIP trust each tax year
- the life tenant is assessed in the tax year of entitlement (i.e. the same tax year as the trustees account for the trust income), not in the year of receipt
- the income of an IIP trust is received by the beneficiary net of 20% tax (8.75% for dividends)
- a 20% tax credit (8.75% for dividends) is available to deduct from the IT liability of the beneficiary.

Discretionary trusts

- the beneficiary of a discretionary trust only receives income at the discretion of the trustees
- any income distributed from a discretionary trust is assessed on the beneficiary in the tax year of receipt
- discretionary trust income is always deemed to be received by the beneficiary net of 45% tax and is always taxed as non-savings income
- a 45% tax credit is available to deduct from the IT liability of the beneficiary.

Taxation of beneficiaries

- the beneficiaries are taxed on the gross trust income in their personal income tax computations and they can deduct from their income tax liability the tax credit deducted at source by the trustees (see Chapter 16)
- the trustees must give the beneficiaries a certificate each tax year showing the amount of trust income the individual must be taxed on, and the associated tax credit
- trustees of a discretionary trust can choose to give income generated from the assets to the beneficiaries who are non-taxpayers so that a repayment of income tax paid by the trustees can be claimed.

4 The capital taxes and trusts



The ATX syllabus requires an understanding of the CGT and IHT consequences of:

- a settlor gifting assets **into** a trust, and
- trustees gifting assets **out of** a trust.

Whilst the assets are in the trust, further charges to capital taxes arise as:

- the trustees are subject to CGT
 - on the gains arising in respect of managing the trust assets each tax year
 - at 20% (28% for residential property)
 - after deducting an annual exempt amount of £3,000 (i.e. half the normal annual exempt amount is available to a trust), and

- they may also be liable to pay IHT:
 - in respect of the property held in the trust every ten years (known as the principal charge), and
 - on transfer of assets out of the trust (known as exit charges).



The ATX syllabus requires knowledge of these charges to tax, however, the calculation of CGT and IHT payable by the trustees is not examinable.

Other types of trusts



There are several types of trusts available with different IHT consequences. However, the only trusts examinable at ATX are:

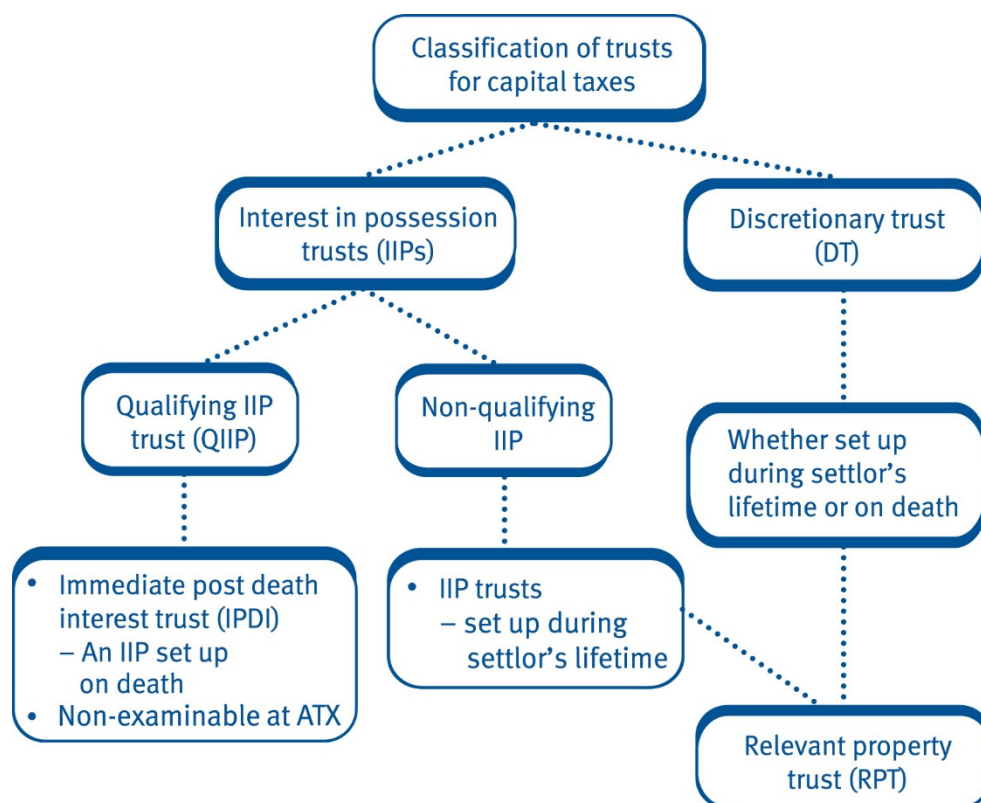
- Relevant property trusts (RPTs).

For the purposes of ATX, RPTs are defined as all trusts created on or after 22 March 2006 i.e. discretionary trusts and non-qualifying interest in possession trusts.

Note that an interest in possession trust created on the death of a settlor is sometimes referred to as an 'immediate post death interest (IPDI) trust' or a 'qualifying interest in possession (QIIP) trust'.

The capital tax implications of IPDI trusts are not examinable at ATX.

Summary



Gifts into a trust

A trust can be created:

- during the settlor's lifetime by means of a lifetime gift, and
- on death under the provisions of the settlor's will or under a deed of variation.

The capital tax consequences of a gift into a trust depend on the type of trust as summarised in the diagrams later in this section.

Capital tax charges whilst in trust

Whilst the assets are in the trust, the trustees are subject to CGT on the gains arising in respect of managing the trust assets each tax year.

Trustees may also be liable to a principal charge for IHT which is levied on RPTs only, every ten years following the creation of the trust.

The maximum rate of IHT payable on the principal charge is 6%.

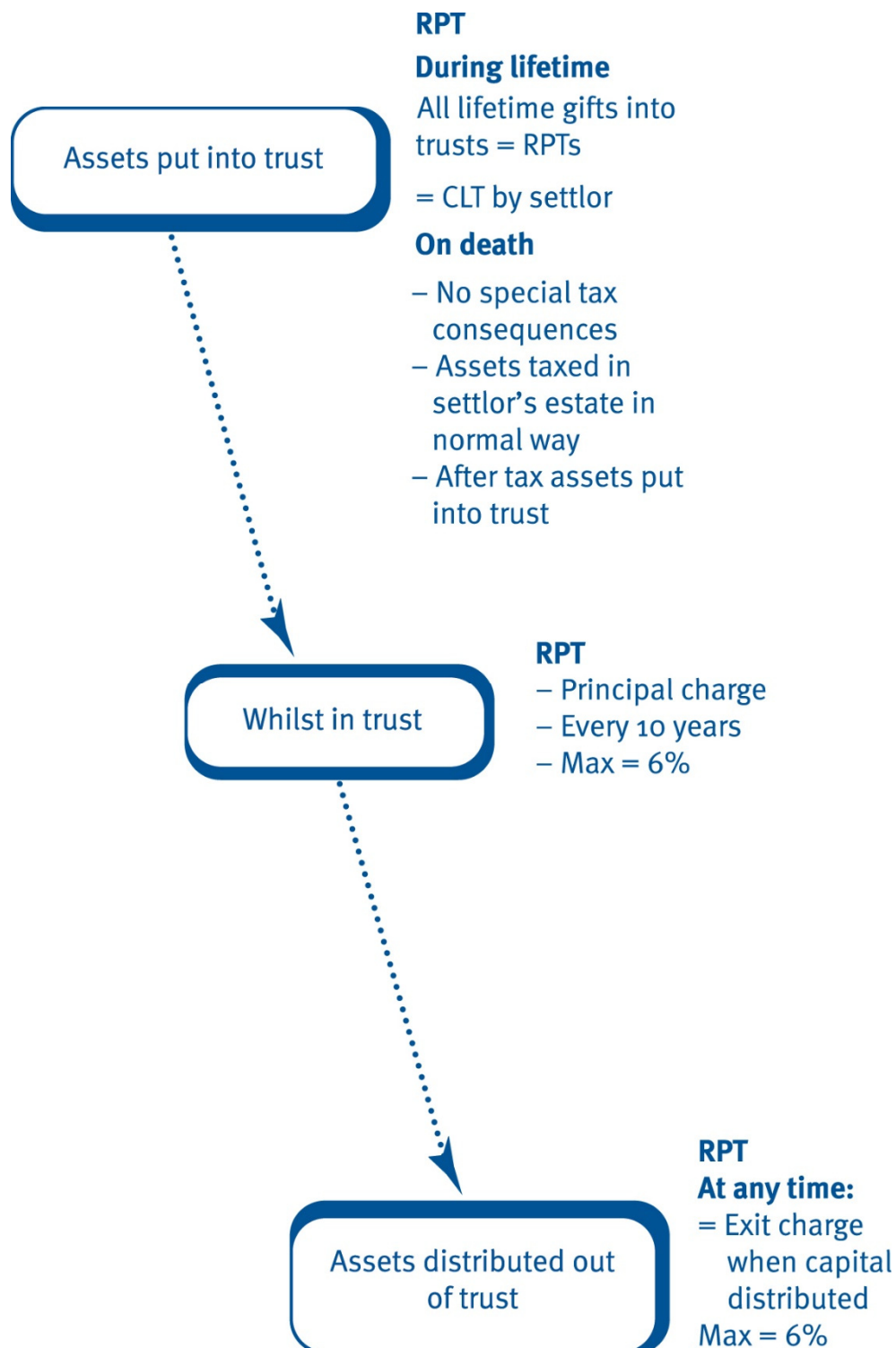
The calculation of the CGT payable and the IHT principal charge payable by the trustees is not examinable.

Gifts out of a trust

Where a gift of assets is made out of a trust to a beneficiary, the gift is known as a 'capital distribution' and the property passes to the beneficiary 'absolutely' (i.e. the legal title of the property passes to the beneficiary).

The capital tax consequences of making capital distributions out of a trust to the beneficiaries depends on the type of trust as summarised in the diagrams later in this section.

Inheritance tax consequences



Capital gains tax consequences

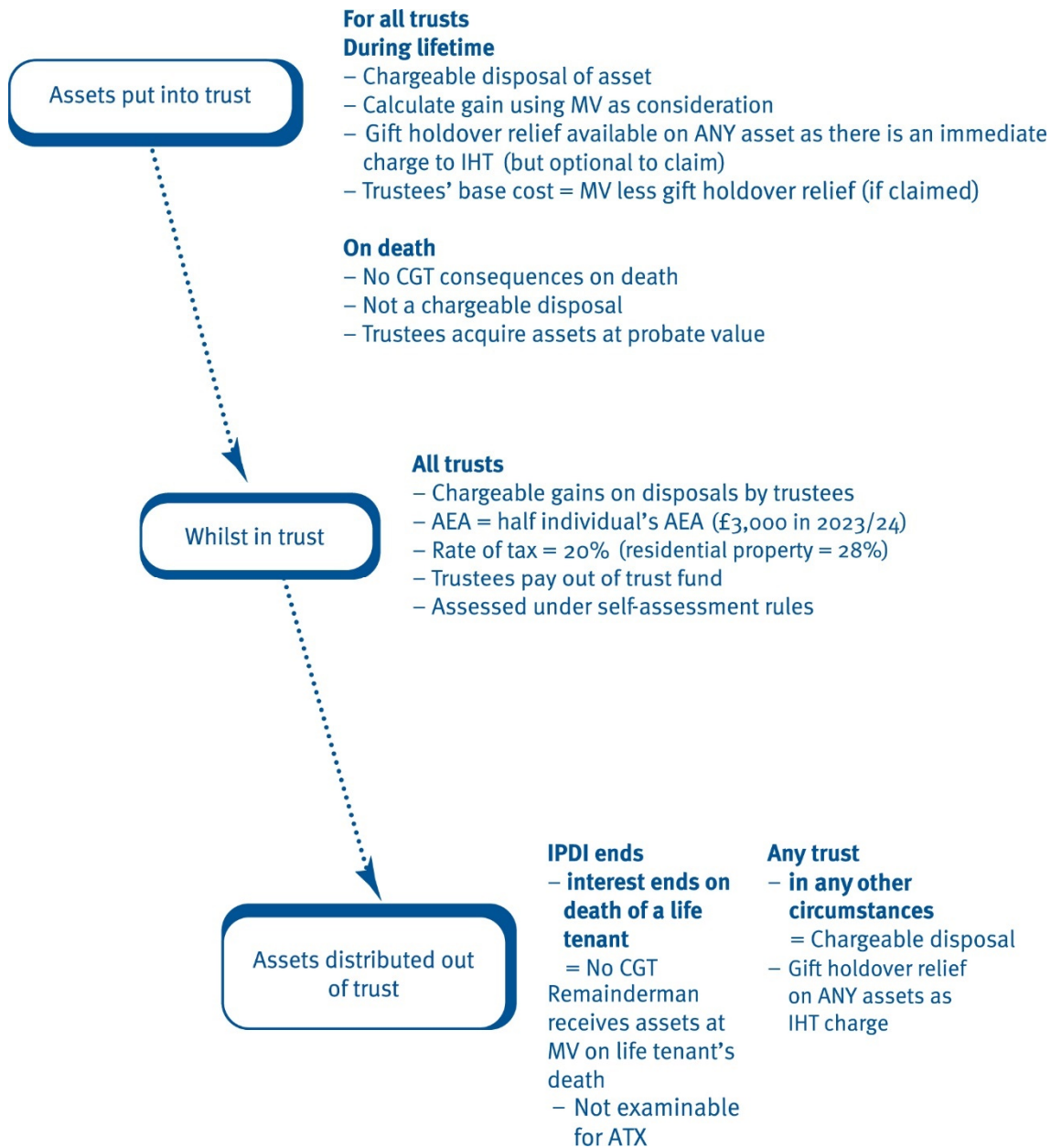




Illustration 3 – The capital taxes and trusts

Habiba died on 19 May 2023 leaving a widower and two children. She had made no lifetime gifts and her estate on death is valued at £422,000.

Under the terms of her will, she requested that a discretionary trust be set up for her children with cash of £325,000 from her estate. The remainder is to go to her husband.

Calculate the IHT and CGT arising on Habiba's death and show how the estate is distributed between the beneficiaries.

Solution

Capital gains tax

- There is no CGT to pay on death.
- Any chargeable assets going into the trust have a base cost equal to the probate value.

Inheritance tax

Habiba: Estate computation

	£
Estate value	422,000
Less: Exempt legacies – Spouse	(97,000)
	<hr/>
Gross chargeable estate	325,000
	<hr/>
This is covered by the NRB available.	
IHT on death	0
	<hr/>

Distribution of the estate

Residue to husband	97,000
Cash to trust	325,000
IHT to HMRC re: creation of trust	0
	<hr/>
	422,000
	<hr/>

Note: Use of discretionary trusts is advantageous if:

- The individual wants to control who the ultimate beneficiary of the trust will be, rather than leave the decision to the surviving spouse or civil partner.
- The assets on the first death are likely to increase in value at a faster rate than the NRB. The growth of the assets will be in the trust fund and not be included in the surviving spouse or civil partner's estate.



Illustration 4 – Discretionary trust

Kenza, a wealthy farmer and landowner has decided to set up a discretionary trust for the benefit of various family members.

- On 6 May 2023 Kenza put some shares in Windmill plc into the trust. She originally bought the shares for £20,000 on 1 May 2011. On 6 May 2023 the quoted shares have a market value of £50,000 for IHT purposes and £52,000 for CGT purposes. Kenza has not made any previous lifetime gifts.
 - On 30 November 2026, the trustees distribute the shares to Kenza's grandson absolutely. Assume the market value of the quoted shares at that date will be £90,000 for IHT purposes and £95,000 for CGT purposes.
- (a) **Explain an advantage for Kenza of setting up a discretionary trust during her lifetime.**
 - (b) **Explain the capital tax consequences resulting from the creation of the discretionary trust on 6 May 2023.**
 - (c) **Explain the tax consequences arising during the life of the trust.**
 - (d) **Explain the capital tax consequences of distributing the property out of the trust to Kenza's grandson absolutely on 30 November 2026.**
 - (e) **Explain the capital tax consequences of creating the trust and the distribution to the grandson assuming the discretionary trust had been set up on Kenza's death in December 2024, rather than a lifetime gift. Assume the market value of the shares in December 2024 will be £60,000 for both IHT and CGT purposes.**

Assume the tax year 2023/24 tax rates and allowances apply throughout.

Solution

- (a) **Advantages of setting up a discretionary trust during lifetime**
Assets placed in the trust can appreciate in value outside of both Kenza's and her grandson's estates.

If the grandson is a non-taxpayer, a repayment of income tax paid by the trustees may be available.

(b) Capital tax consequences of the creation of the trust**Inheritance tax**

- Lifetime gift into a RPT = a CLT by Kenza
- Based on £50,000 IHT value less exemptions
- Lifetime IHT payable
- Payable by Kenza or trustees by agreement
- If Kenza dies within seven years: Additional IHT payable on death
- Death IHT payable by trustees from trust assets.

Capital gains tax

- Chargeable disposal of asset at full MV of £52,000 for CGT purposes
- Gift holdover relief available on any asset as there is an immediate charge to IHT
- Therefore no CGT payable when the assets are put into trust, the gain is held over against the base cost of the shares acquired by the trustees.

2023/24	£
MV of shares put into trust (May 2023)	52,000
Less: Cost (May 2011)	(20,000)
	<hr/>
Capital gain before reliefs	32,000
Less: Gift holdover relief	(32,000)
	<hr/>
Chargeable gain	0
	<hr/>
Base cost of the shares to the trustees	£
MV of shares put into trust (May 2023)	52,000
Less: Gain held over – gift holdover relief	(32,000)
	<hr/>
Base cost	20,000
	<hr/>

(c) Tax consequences during the life of the trust**Income tax**

The trustees will be subject to income tax on the income received from the trust assets.

The trustees account for income tax each tax year under self-assessment.

Inheritance tax

IHT at a maximum rate of 6% will be charged every ten years based on the value of the assets in trust on the principal charge date.

The first principal charge will be on 6 May 2033.

Capital gains tax

The trustees will manage the trust fund. They will buy and sell capital assets to maintain and grow the fund on behalf of the beneficiaries.

The sale of trust assets will give rise to capital gains which will be subject to CGT.

The trustees account for CGT each tax year under self-assessment.

(d) Capital tax consequences of the distribution to the grandson

Inheritance tax

- An exit charge arises
- Based on £90,000 IHT valuation
- Trustees pay a maximum of 6% of the value of the capital distribution.

Capital gains tax

- Chargeable disposal of asset at full MV
- Gift holdover relief available on any asset as there is an immediate charge to IHT
- Therefore no CGT payable when the assets are distributed out of the trust, the gain is held over against the base cost of the shares acquired by the grandson.

2026/27	£
MV of shares (November 2026)	95,000
Less: Base cost of shares	(20,000)
	<hr/>
Capital gain before reliefs	75,000
Less: Gift holdover relief	(75,000)
	<hr/>
Chargeable gain	0
	<hr/>

Base cost of shares acquired by the grandson

	£
MV of shares (November 2026)	95,000
Less: Gain held over	(75,000)
	<hr/>
Base cost	20,000
	<hr/>

(e) If the discretionary trust is created on Kenza's death**Capital tax consequences of the creation of the trust****– Inheritance tax**

- Assets form part of Kenza's estate
- Included at a valuation of £60,000
- Trust is established after the estate IHT has been paid (i.e. out of after tax assets).

– Capital gains tax

- No CGT consequences on death
- Not a chargeable disposal, no CGT payable
- Trustees acquire assets at IHT probate value of £60,000.

Capital tax consequences of the distribution to the grandson

The same consequences as in part (d), with the exception of the CGT valuation.

2026/27	£
MV of shares (November 2026)	95,000
Less: Cost of shares (probate value December 2024)	(60,000)
	<hr/>
Capital gain before reliefs	35,000
Less: Gift holdover relief	(35,000)
	<hr/>
Chargeable gain	0
	<hr/>

Base cost of shares acquired by the grandson

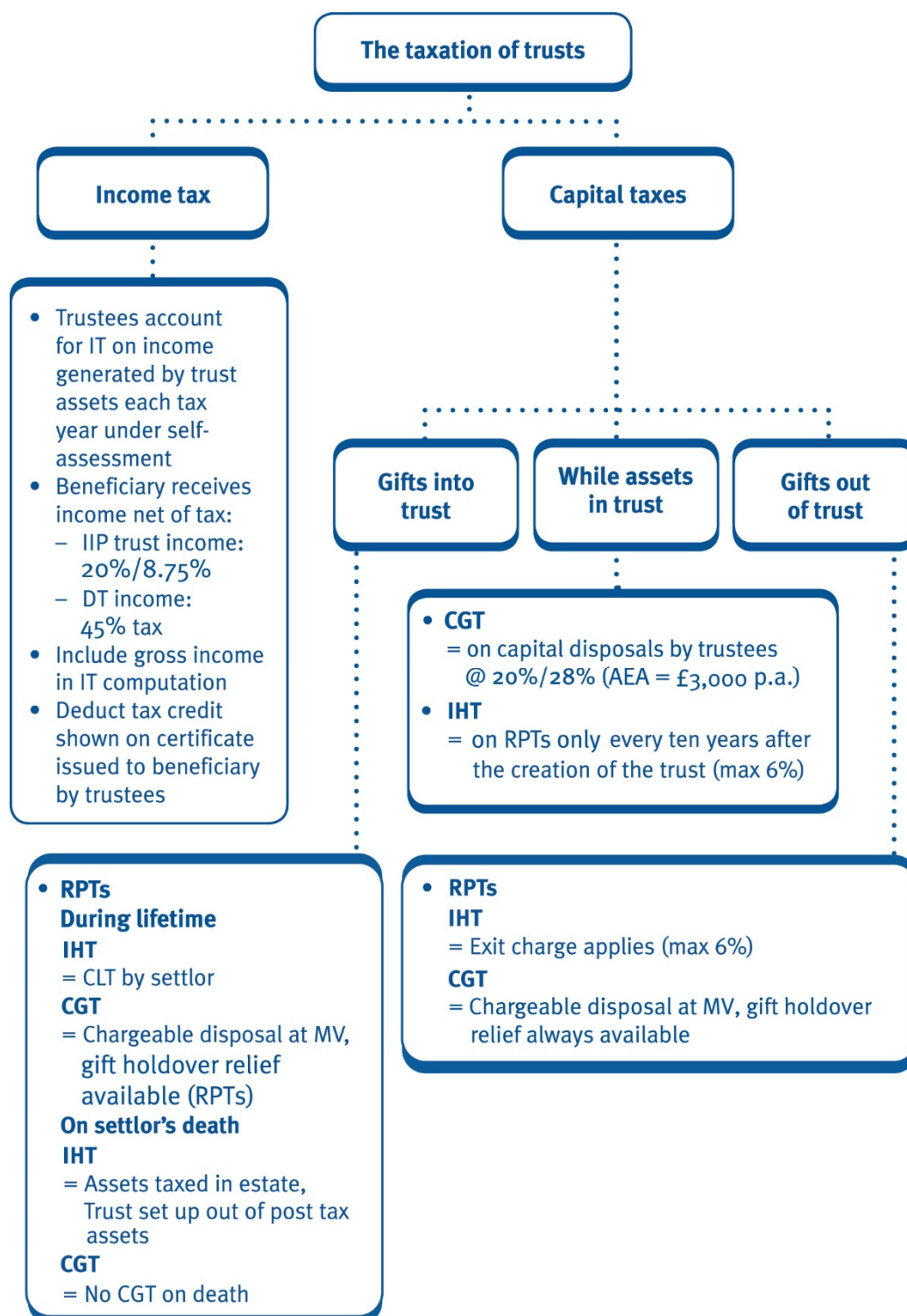
	£
MV of shares (November 2026)	95,000
Less: Gain held over	(35,000)
	<hr/>
Base cost	60,000
	<hr/>

5 Tax planning opportunities

The following tax planning opportunities arise from creating a trust:

- By gifting assets into a trust during the individual's lifetime, the assets will no longer form part of the settlor's estate on death.
- Assets which appreciate in value can be transferred into the trust and will increase in value outside of both the settlor's and the beneficiaries' estates.
- The exit charges and principal charges levied on some trusts are a maximum of 6% which may not be significant in the context of the financial planning requirements of the individual settlor.
- Trustees of a discretionary trust can choose to give income generated from the assets to the beneficiaries who are non-taxpayers so that a repayment of income tax paid by the trustees can be claimed.

6 Chapter summary



Ethics

Chapter learning objectives

Upon completion of this chapter you will be able to:

- advise on the increased penalties which apply in relation to offshore matters
- be aware of the ethical and professional issues arising from the giving of tax planning advice



One of the PER performance objectives (PO16) is to ensure individuals and entities comply with their tax obligations. These should be on time, and in the spirit and letter of the law. Another (PO1) covers various aspects of ethics and professionalism. Working through this chapter should help you understand how to demonstrate those objectives.



Introduction

This chapter covers the area of ethics.

Professional ethics is an essential attribute required in practice and a topic which will appear for five marks in every examination as part of question 1.



Much of the content has already been covered in your earlier studies as ethics applies to every part of the qualification. However, at ATX the principles must be learnt and applied to tax scenarios to provide advice to clients.



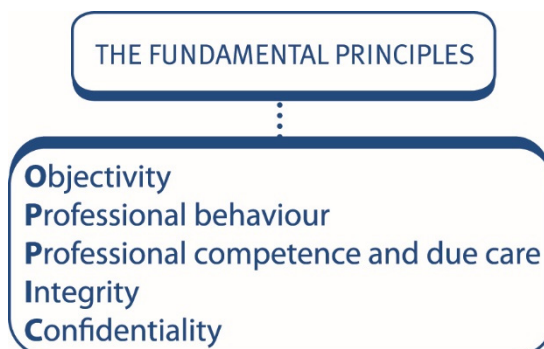
In the exam, you should be prepared to demonstrate professional scepticism when considering ethical issues and information provided by a client. You may need to apply ethical judgement when analysing and evaluating courses of action.

1 Professional Code of Ethics

Overview

The ACCA 'Professional Code of Ethics and Conduct' sets out the standards of professional conduct expected from the members and students of the Association, and sets a framework of principles that should be applied. Guidance is also contained within the 'Professional Conduct in Relation to Taxation' provisions.

Failure to comply with this code could lead to disciplinary action.



Remember: OPPIC

A reminder of the definitions of the fundamental principles are as follows:

Objectivity (O)

- Members should not allow bias, conflicts of interest or the influence of others to override objectivity and to affect their business decisions.

Professional behaviour (P)

- Members must comply with relevant laws and avoid actions that may discredit the profession.

Professional competence and due care (P)

- Members have an ongoing duty to maintain professional knowledge and skills to ensure that a client/employer receives competent, professional service based on current developments.
- Members should be diligent and act in accordance with applicable technical and professional standards when providing professional services.

Integrity (I)

- Members should be straightforward and honest in all their professional and business relationships.

Confidentiality (C)

- Members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties unless:
 - they have proper and specific authority, or
 - there is a legal or professional right or duty to disclose (e.g. money laundering).
- Confidential information acquired as a result of professional and business relationships, should not be used for the personal advantage of members or third parties.

New clients

A member is required to exercise professional expertise when dealing with clients.

Before taking on a new client the member should consider whether:

- acting for the client will pose any risk to the practice in terms of the client's integrity. This would include assessing the potential client's personal and business circumstances, and attitude to disclosure and compliance with tax law
- the member and the firm have the skills and competence to service the client's requirements
- the potential client is involved in any activity that could be considered as money laundering.

In the case of a limited company, the following information should be gathered:

- Proof of incorporation and primary business address and registered office.
- The structure, directors and shareholders of the company.
- The identities of those persons instructing the firm on behalf of the company and those persons that are authorised to do so.

In the case of an individual, the following information should be gathered:

- Proof of identity and residential address.
- Any unincorporated business interests and if so details of the nature and structure and those persons that are authorised to act on behalf of the business (e.g. partners in a partnership).

Once it has been decided that the member can act for the client, the member should:

- ask permission to contact the previous advisors to request the information necessary to decide whether it is possible to act for the client (the previous advisor should seek the client's permission before discussing the client's situation with the new advisor)
- if the client does not give permission to contact the previous advisors the member should give serious consideration as to whether it would be appropriate to act for the client.

Assuming the situation is satisfactory and it is decided to act for the client the member should issue a letter of engagement setting out the terms and conditions of the arrangement, and other relevant items.



Illustration 1 – New clients

Where a member is asked to replace a client's existing advisors the member must request the permission of the prospective client to contact the existing advisor.

What is the reason for this communication?

Solution

The main purpose of the communication is to ensure that the member:

- is aware of any factors that may be relevant to the decision as to whether to accept the work
- is aware of any factors that may have a bearing on ensuring full disclosure of relevant items is made to HMRC
- has the information with regard to filing deadline, elections and claims relating to the client so that no matters are overlooked during the period of the move to the new advisor.

Conflicts of interest

A member should not put themselves in the position where acting for two clients creates a conflict of interest.

If the member becomes aware of a potential conflict, the member should act immediately to address it. Where no appropriate action can be taken to avoid the conflict the member should cease to act in the matter where the conflict arose.

Conflicts can occur in the following situations:

- where a member acts for a client and is then asked to act for another party in a transaction
- acting for both parties in a divorce
- acting for the employer and their employees
- where the advisor may benefit from the transaction.

It may be acceptable to act for both parties, as long as the following safeguards are put in place:

- the potential conflict should be pointed out to all of the relevant parties
- consent should be obtained to act for them
- the firm must have clear guidelines in relation to confidentiality, and
- should consider the need to use separate teams for each client.

Alternatively, the firm may consider acting for just one party, or not acting for either party.



Test your understanding 1

Mutya has been asked to act for both parties to a transaction.

Describe the three courses of action open to Mutya.



Test your understanding 2

Simon is about to give some tax advice to his client. If the client acts on this advice Simon will receive commission of £2,000 from a third party.

What action should Simon take?

Dealing with HMRC

It is important to ensure that information provided to HMRC is accurate and complete.

A member must not assist a client to plan or commit any offence.

If a member becomes aware that the client has committed a tax irregularity:

- the member must discuss it with the client, and
- ensure that proper disclosure is made.

Examples would include:

- not declaring income that is taxable
- claiming reliefs to which the client is not entitled
- not notifying HMRC where a mistake has been made giving rise to an underpayment of tax, or an increased repayment.

Where a client has made an error:

- it will be necessary to decide whether it was a genuine error or a deliberate or fraudulent act.

Once an error has been discovered

- the member should explain to the client the requirement to notify HMRC as soon as possible, and the implications of not doing so.

The letter of engagement may include a section with regard to disclosure of information to HMRC, if so it would be courteous to inform the client of the intention to disclose.

Should the client refuse to make a full and prompt disclosure to HMRC:

- the member must write to the client and explain the potential consequences, and
- consider whether the amount is material, and if it is, whether the member should continue to act for the client.

If the client still refuses to make a full disclosure, the member:

- should cease to act for the client
- must then also write to HMRC informing it of the cessation, but without disclosing the reason why
- must then consider the member's position under the Money Laundering Regulations.



Test your understanding 3

When you are checking a recent tax computation from HMRC you notice that they have made an error which has resulted in your client receiving a larger repayment than should have been made.

What actions should you take?

Employees

Where the member is an employee, the member may become aware of irregularities in the employer's dealings with HMRC.

The employee should raise any concerns with the appropriate person.

If the employer refuses to take any appropriate action the employee should seek advice from the professional body. In addition, the employee needs to consider:

- the need to report to the employer's Money Laundering Officer
- whether it is appropriate to continue in the current employment
- if it is necessary to disclose under the Public Interest Disclosure Act.

Where the employee is responsible for agreeing the employer's tax liabilities with HMRC, the employee is in a similar position to members in practice.

If the employee discovers an error, default or fraud, the employee should bring it to the attention of the employer, and encourage the employer to disclose the relevant information.



Illustration 2 – Employees

You have recently moved to work in the tax department of a medium sized trading company. You have been reviewing the recently submitted tax return and have identified several material errors.

You have brought this information to Cliff, the head of the department, but he refuses to adjust the figures as this will increase the tax payable for the year and impact on his bonus.

What action should you take?

Solution

Taking no action is not permissible, so the following should be considered.

- Is there anyone else in the company with whom it may be appropriate to discuss these concerns?
- Consider taking advice from the ACCA or legal advice on the relevant course of action.
- Consider making a report to the company's Money Laundering Reporting Officer, if there is one and, if not, direct to the NCA.
- Consider looking for alternative employment.
- Consider whether disclosure should be made under the Public Interest Disclosure Act. Does the employer have in place any policies with regard to disclosures under this act? Consider taking legal advice before pursuing this course of action.

You should keep a record of all action taken to demonstrate that you have acted properly throughout.

Money Laundering Regulations

Money laundering is the term used for offences including benefiting from or concealing the proceeds of a crime.

This includes tax evasion.

All businesses within regulated sectors must appoint a Money Laundering Reporting Officer (MLRO) within the firm.

The MLRO will decide whether a transaction should be reported to the National Crime Agency (NCA).

Where a report is made the client should not be informed as this may amount to 'tipping off', which is an offence.

A report to the NCA does not remove the requirement to disclose the information to HMRC.

Dishonest conduct of tax agents

- There is a civil penalty of up to £50,000 for dishonest conduct of tax agents.
- In cases where the penalty exceeds £5,000, HMRC may publish details of the penalised tax agent.
- With agreement of the Tax Tribunal, HMRC can access the working papers of a dishonest agent.

Tax avoidance or evasion

Tax evasion is unlawful. A taxpayer who dishonestly withholds or falsifies information for tax evasion purposes may be subject to criminal proceedings or suffer civil penalties.

A tax advisor who is a party to tax evasion is subject to the sanctions of the criminal law. Concealment of material facts may constitute tax evasion.

Tax avoidance is the use of legitimate means to reduce the incidence of tax. A tax advisor may properly advise or assist clients to reduce their liability to tax. However, the courts are wary of schemes or arrangements, the sole purpose of which is to avoid tax.

In recent years:

- The courts have taken an increasingly firm stance in finding that such schemes do not achieve their purpose.
- Specific anti-avoidance schemes have been targeted by HMRC with legislation to counter the **tax advantages** gained by the taxpayer. Tax advantages include the reduction of tax liabilities, increase of tax deductions allowed, deferral of tax payments and acceleration of tax repayments.

- HMRC has also introduced:
 - disclosure obligations regarding anti-avoidance tax schemes requiring the declaration of the details of the scheme to HMRC
 - penalties for those who enable the use of tax avoidance arrangements which HMRC later defeats
 - **a general anti-abuse rule (GAAR)** to counteract **tax advantages** arising from **abusive tax arrangements**.
- The concept of **serial tax avoidance** was introduced to further strengthen the regime designed to prevent aggressive tax avoidance. Those who persistently engage in tax avoidance schemes which are defeated by HMRC will be subject to a regime of increasing penalties and may have their details published by HMRC.



The ATX examining team expect you to be aware that there has been a general tightening of the rules in relation to aggressive tax avoidance, but they do not expect you to know the details.

General anti-abuse rule

- The meanings of the relevant terms are:
 - 'Tax advantages' include increased tax deductions, reduced tax liabilities, deferral of tax payments and advancement of tax repayments.
 - 'Tax arrangements' are arrangements with a main purpose of obtaining a tax advantage.
 - Arrangements are 'abusive' where they cannot be regarded as a reasonable course of action, for example, where they include contrived steps or are intended to take advantage of shortcomings in the tax legislation.
- If the GAAR applies, HMRC may respond by increasing the taxpayer's liability, accelerate tax payments or defer repayments and ignore artificial steps in a contrived abusive scheme. Any adjustments that are made will be just and reasonable to counteract the advantage gained.
- A penalty of 60% of the tax advantage counteracted by the GAAR can be levied.



Penalties for offshore non-compliance

To counter **tax evasion** by taxpayers **deliberately** concealing taxable income, gains and assets **overseas** (i.e. outside of the UK):

- a higher tax-geared penalty regime applies
- in relation to errors concerning offshore income and capital gains.

This regime relates to:

- failures to notify liability or chargeability to tax
- failures to submit a return on time, and
- errors in a submitted return.

The regime applies to income tax, capital gains tax and inheritance tax.

The higher offshore non-compliance penalties apply if:

- HMRC discovers that an asset has been moved overseas, and
- one of the above penalties applies, and
- the penalty for deliberate behaviour is due, and
- the asset move was a 'relevant offshore asset move'
- which took place in order to prevent or delay HMRC discovering about the asset.

There are four levels of penalty, the amount of which depends on:

- the overseas territory used
- (four categories exist and have been defined by the Treasury), and
- the existence of, and degree of exchange of, information with HMRC.

The penalties are applied to:

- the taxpayer, and
- anyone who assisted the taxpayer in committing the offence.



The ATX examining team do not expect you to know the detail in relation to the amount of the penalties or categorisation of overseas territories.

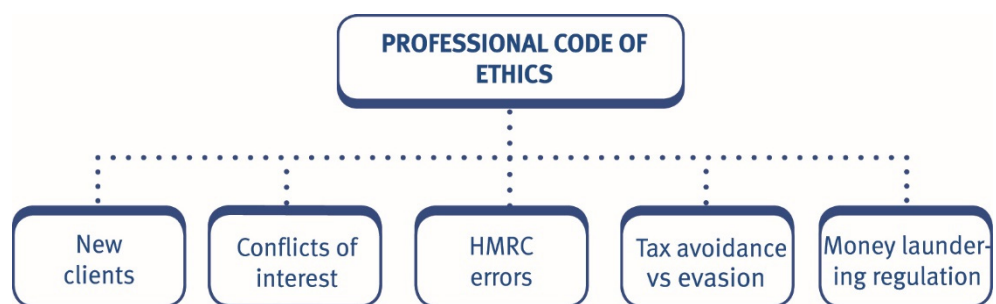
A 'relevant asset move' means that

- an asset has been moved from a country that exchanges information with the UK to one that does not, or
- the owner of the asset has ceased to be resident in a country that exchanges information with the UK and becomes resident in a country that does not.

Note that these penalties only impact on:

- non-compliant individuals
- who have carelessly or deliberately submitted inaccurate information, or
- failed to notify HMRC about income or gains from activities/sources or assets held abroad.

2 Chapter summary



Test your understanding answers



Test your understanding 1

Mutya

- (1) Act for neither party

This option may not be in the best interests of everyone but if there is any doubt it is the recommended course of action.

- (2) Act for both parties

This may be possible if the facts have been disclosed to both parties involved and they agree. Both clients should be advised to seek independent advice as to whether it is appropriate for the member to act for both parties.

- (3) Act for one client

This would normally be the client who first sought advice from the member.



Test your understanding 2

Simon

Simon should inform the client that commission will be receivable, and the amount involved.

He needs to ensure that the commission does not taint his advice, and he preserves the normal standards of care with the advice being in the best interests of the client.

**Test your understanding 3****HMRC error**

The position should be reviewed carefully to confirm that an error has been made.

The client should be contacted for authority to disclose the error to HMRC, if this authority was not already given within the letter of engagement.

If the authority does not exist in the letter of engagement, the client should be told the consequences of not disclosing the error, including the implication for interest and penalties.

If the client refuses to allow the disclosure it would be necessary to consider whether the amount is material, and if it is, whether you can continue to act for the client.

If it is decided that it is not appropriate to continue acting, the client must be informed in writing. HMRC should also be notified that you have ceased to act, but not the reason why.

It may be necessary to make a report to the NCA under the Money Laundering Regulations.

Personal tax administration

Chapter learning objectives

Upon completion of this chapter you will be able to:

- understand the statutory obligations imposed in a given situation, including any time limits for action and advise on the implications of non-compliance.



One of the PER performance objectives (PO16) is to ensure individuals and entities comply with their tax obligations. These should be on time, and in the spirit and letter of the law. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter covers the area of tax administration for individuals.



The personal tax administration in this chapter is important to remember and apply. Much of the content is a revision of the rules covered in TX. A brief reminder is given and revision examples provided to check your retention of TX knowledge. Although this is mostly brought forward knowledge it still gets tested frequently in the ATX exam as it is something that is crucial to consider when advising clients.

1 Personal tax administration

The collection of income tax

Employees have their income tax and national insurance liabilities on their employment income, and in some cases on small amounts of other income, collected at source through the PAYE system.

Self-assessment is the system for the collection of tax which is not deducted through the PAYE system.

Therefore, employees with more complicated tax affairs and other taxpayers (e.g. the self-employed) will normally be required to submit details of their taxable income and gains annually in a tax return, so that their tax liability can be calculated and collected through the self-assessment system.

Self-assessment

Under the self-assessment system, the taxpayer will normally be required to provide HMRC with details of all taxable income in a tax return.

Certain taxpayers with relatively straightforward tax affairs may instead be issued with a simple assessment. However, the simple assessment system is not examinable.

Tax returns

Under the self-assessment system for the majority of individuals the onus is placed on the taxpayer to provide the information to calculate the tax liability.

- The taxpayer is sent a notice to complete a self-assessment tax return annually.
- The responsibility for providing information, calculating and accounting for income tax, class 2 and 4 NICs and CGT lies with the taxpayer.
- The taxpayer must complete and file (i.e. submit) a return with HMRC on paper or electronically.
- Different deadlines exist for filing paper and electronic (online) returns.

Return – filing deadline

The deadline for submitting the 2023/24 self-assessment tax return depends on how the return is filed.

The deadline for submitting the return is the **later** of:

- 31 October 2024 for a paper return
- 31 January 2025 for an electronic (online) return
- three months after a notice to file a return is issued by HMRC.

The 31 January following the end of the tax year is known as the '**filing date**', regardless of whether the return is filed on paper or electronically.

This must be distinguished from the date on which the return is actually filed/submitted, which is the 'actual filing date'.



A reminder of other key aspects of self-assessment covered at TX is given below and is summarised in the diagram in section 2.



The content of a tax return

The taxpayer completes the main tax return form (SA100) to give basic details including the taxpayer's name, address and certain types of investment income.

The taxpayer should then complete relevant supplementary pages to tell HMRC about all income and gains relating to the tax year. For example, income from employment, income from property, or capital gains.

If the taxpayer is completing the tax return online, these supplementary pages can be added as necessary. If the taxpayer is completing a paper tax return, the supplementary pages needed should be requested at the same time as the main tax return.

- **Self-employed people:** Should complete the self-employment supplementary pages.
- **Employees:** Generally, pay their tax liability under PAYE and often a self-assessment tax return will not be required as there is no further tax liability. However, if they receive taxable income that is not fully taxed through the PAYE system, they will need to complete a tax return.

Partnerships: Although partners are dealt with individually, a partnership return is required to aid self-assessment on the individual partners. This gives details of the partners, includes a partnership statement detailing the partnership's tax adjusted trading income and shows how it is allocated between the partners.

Return – calculation of tax

- Where a return is filed electronically:
 - a calculation of the tax liability is automatically provided as part of the online filing process.
- Where a paper return is submitted:
 - HMRC will calculate the tax liability on behalf of the taxpayer, provided the return is submitted by the 31 October deadline. Alternatively, the taxpayer can opt to calculate the tax.
 - the calculation by HMRC is treated as a self-assessment on behalf of the taxpayer.
- Where HMRC calculates the tax, it makes no judgement of the accuracy of the figures included in the return, but merely calculates the tax liability based on the information submitted.
- HMRC normally communicates with the taxpayer by issuing a statement of account which is a reminder of amounts owing to HMRC.



Amendments to the return

Either party may amend the return:

- HMRC may correct any obvious errors or mistakes within **nine months** of the date that the return is filed with them.

These would include arithmetical errors or errors of principle. However, this does not mean that HMRC has necessarily accepted the return as accurate.
- The taxpayer can amend the return within **12 months** of the 31 January filing date. For the tax year 2023/24, amendments must therefore be made by 31 January 2026.

Note that the deadline is the same regardless of whether the return is filed on paper or electronically.

If an error is discovered at a later date then the taxpayer can make a claim for overpayment relief (see later) to recover any tax overpaid.



Notification of chargeability

Self-assessment places the onus on the taxpayer, therefore:

- Taxpayers who do not receive a notice to file a return are required to notify HMRC if they have income or chargeable gains on which tax is due.
- The time limit for notifying HMRC of chargeability is six months from the end of the tax year in which the liability arises (i.e. 5 October 2024 for the tax year 2023/24).
- Notification is not necessary if there is no actual tax liability. For example, if the income or capital gain is covered by allowances or exemptions.
- A standard penalty may arise for failure to notify chargeability (see section 7).

Penalties for failure to submit a return

HMRC can impose fixed penalties and tax-geared penalties for the failure to submit a return, depending on the length of delay.

See section 7 for the detail on the penalties that can be imposed.



Determination of tax due if no return is filed

Where a self-assessment tax return is not filed by the filing date, HMRC may determine the amount of tax due. The impact of this is:

- The determination is treated as a self-assessment by the taxpayer.
- The determination can only be replaced by the actual self-assessment when it is submitted by the taxpayer (i.e. the submission of a tax return).
- There is no appeal against a determination, which therefore encourages the taxpayer to displace it with the actual self-assessment.

A determination can be made at any time within **three years** of the filing date (i.e. by 31 January 2028 for the tax year 2023/24).



Claims

Wherever possible a claim for a relief, allowance or repayment can be made to HMRC usually by including it in the self-assessment tax return.

The amount of the claim must be quantified at the time that the claim is made. For example, if loss relief is claimed, then the amount of the loss must be stated.

Claims for earlier years

Certain claims will relate to earlier years. The most obvious example of this is the claiming of loss relief for earlier years.

The basic rule is that such a claim is:

- established in the later year
- calculated based on the tax liability of the earlier year.

The tax liability for the earlier year is not adjusted. Instead, the tax reduction resulting from the claim will be set off against the tax liability for the later year. The logic is that it avoids re-opening assessments for earlier years.

Alternatively, if a separate claim is made HMRC will refund the tax due.

As the claim is only quantified by reference to the later year, POAs that are based on the relevant amount for the earlier year will not change.

Claim for overpayment relief

Where an assessment is excessive due to an error or mistake in a return, the taxpayer can claim relief. The claim must be made within four years of the end of the tax year concerned.

For the tax year 2023/24 the claim should be made by 5 April 2028.

A claim can be made in respect of errors made, and mistakes arising from not understanding the law.



Illustration 1 – Claims for earlier years

Hywyn's relevant amount for the tax year 2022/23 is £4,400. In the tax year 2023/24 Hywyn makes a trading loss of £1,000, and makes a claim to offset this against his total income of the tax year 2022/23.

Explain how Hywyn will receive the tax refund arising as a result of the relief for the loss arising in the tax year 2023/24.

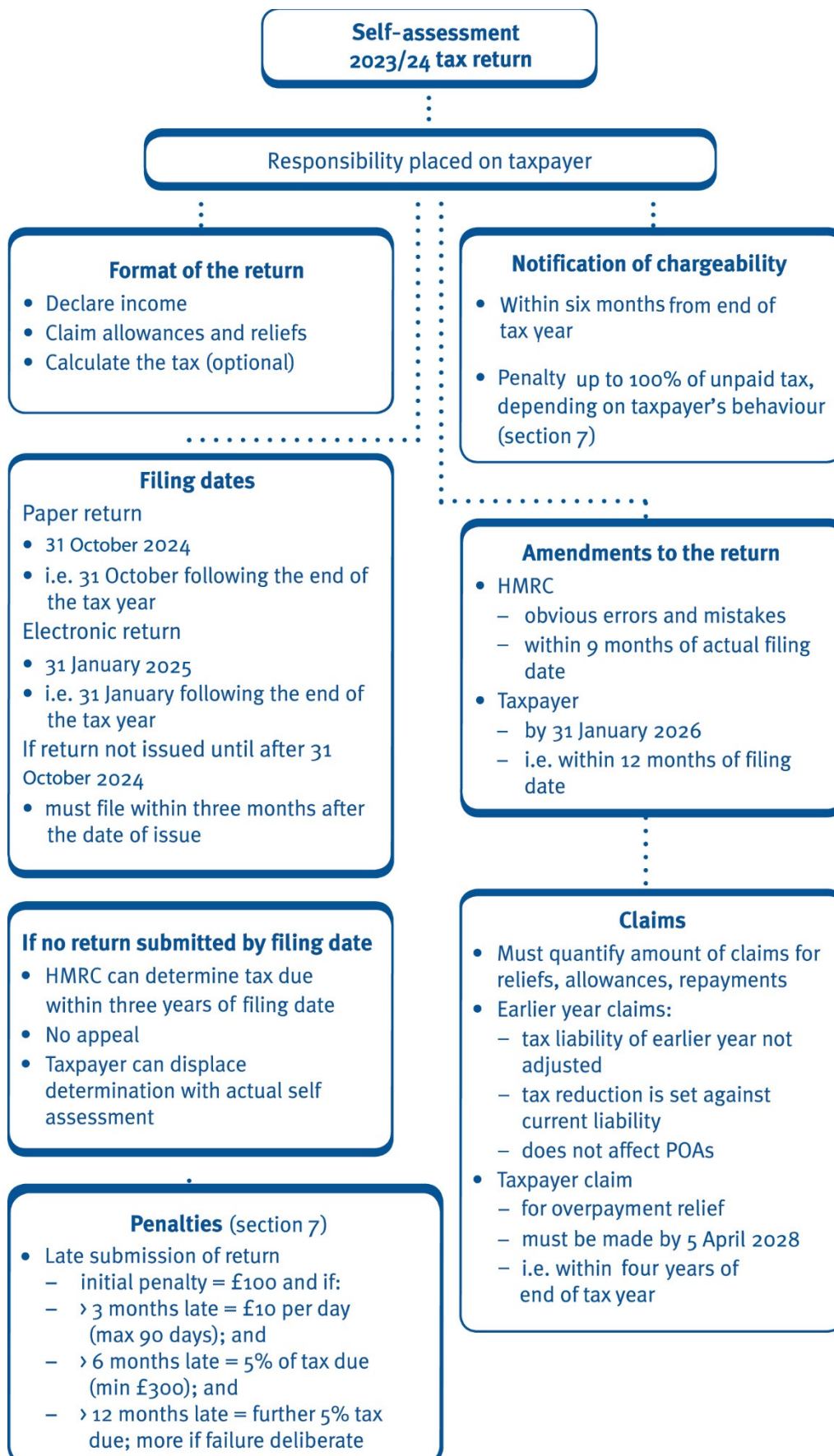
Solution

Hywyn's POAs for the tax year 2023/24 are £2,200 ($£4,400 \times 1/2$), and these will not change as a result of the loss relief claim.

The tax refund due will be calculated at Hywyn's marginal income tax rate(s) for the tax year 2022/23.

The tax refund due will either be set off against the tax year 2023/24 tax liability, thereby affecting the balancing payment on 31 January 2025, or if there is insufficient tax left owing, HMRC will make a refund.

2 Summary



3 Payment of tax

Any tax due on income which is not deducted at source is payable by self-assessment as follows

- Payment dates

First payment on account (POA)	–	31 January during the tax year.
Second payment on account (POA)	–	31 July following the tax year.
Balancing payment/repayment	–	31 January following the tax year.
- POAs are based on the previous tax year's 'relevant amount' (i.e. total income tax and class 4 NICs liabilities less amounts already taxed at source).
- Each POA is 50% of the 'relevant amount'.
- No POAs are ever required for CGT liabilities or class 2 NICs.
- Both CGT and class 2 NICs are due on 31 January following the end of the tax year and do not affect the POAs (Note that payments on account for disposals of UK residential property (Chapter 6) are not part of the self-assessment POAs).



Test your understanding 1

Rebecca's tax payable for the tax year 2023/24 was as follows:

	£
Income tax	10,800
Less: Tax deducted at source	(2,500)
	<hr/>
	8,300
Class 2 NICs	179
Class 4 NICs	800
CGT	4,447
	<hr/>
Total tax liability	13,726
	<hr/>

Two POAs have been paid on 31 January 2024 and 31 July 2024 of £4,000 each.

Calculate the amount payable on 31 January 2025.



A reminder of further rules relating to POAs covered at TX is given below and is summarised in the diagram in section 4.



When POAs are not required

POAs are not required where:

- the relevant amount (i.e. income tax and class 4 NIC liability less tax deducted at source) for the previous tax year is less than £1,000, or
- more than 80% of the assessed tax (i.e. income tax and class 4 NIC) for the previous tax year was met by deduction of tax at source.

Accordingly, most employed people will not have to make POAs, since more than 80% of their tax liability is paid through PAYE.



Claims to reduce POAs

- A taxpayer can claim to reduce POAs, at any time before 31 January following the tax year, if the actual income tax and class 4 NIC liability (net of tax deducted at source) for the tax year 2023/24 is expected to be lower than in the tax year 2022/23.
- The claim must state the grounds for making the claim.

Following a claim:

- The POAs will be reduced.
- Each POA will be for half the reduced amount, unless the taxpayer claims that there is no tax liability at all.
- If POAs based on the prior year figures are paid before the claim, then HMRC will refund the overpayment.

In the event that the claim is incorrect and the actual tax liability for the current year turns out to be higher than the reduced POAs, then the following consequences arise:

- Interest will be charged on the tax underpaid.
- A penalty may be charged if a taxpayer fraudulently or negligently claims to reduce POAs. The maximum penalty is the difference between the amounts actually paid on account, and the amounts that should have been paid.
- A penalty will not be sought in cases of innocent error. The aim is to penalise taxpayers who claim large reductions in payments on account without any foundation to the claim.

Interest and penalties



A reminder of the rules for interest and penalties covered at TX is given below and is summarised in the diagram in section 4.



Late payment interest

Interest will automatically be charged if **any** tax is paid late.

All interest is charged on a daily basis

- from: the day after the tax was due to be paid
- to: the date of payment
- at a rate of 6.5% p.a. (rate given in tax rates and allowances).

However, in the examination, if required, calculations should be performed to the nearest month and £ unless indicated otherwise in the question.



Repayment interest

- Interest may be paid by HMRC on any overpayment of tax at a rate of 3% (rate given in tax rates and allowances).
- If applicable, interest runs from the later of:
 - the date the tax was due, or
 - the date HMRC actually received the tax.
- Interest runs to: the date of repayment
- Interest is only paid on the amount of tax that should have been paid (i.e. deliberate overpayments will not attract interest).



Penalties for late payments

Late payment interest is not a penalty, since it merely aims to compensate for the advantage of paying late.

Therefore, to further encourage compliance, penalties can also be imposed by HMRC where income tax, class 2 NICs, class 4 NICs or CGT is paid late.

Penalties do not apply to POAs.

Penalties are calculated as follows:

Tax paid	Penalty (% of tax due)
More than 1 month late	5%
More than 6 months late	Additional 5%
More than 12 months late	Additional 5%

Note that technically the penalties apply if tax is paid more than 30 days late, 5 months and 30 days late and 11 months and 30 days late, but the ATX examining team gives these time limits to the nearest month and it is acceptable to do so in the examination.

HMRC has the discretion to reduce a penalty in special circumstances, for example if it considers that the penalty would be inappropriate or disproportionate.

However, the inability to pay will not be classified as special circumstances.



Illustration 2 – Interest and penalties

Rowena's tax payable (after credits but before POAs) for the tax year 2023/24 is:

Income tax	£6,000
Capital gains tax	£3,000

POAs of £4,000 in total were made on the relevant dates. The balance of the tax due was paid as follows:

Income tax	28 February 2025
Capital gains tax	31 March 2025

Calculate the interest and penalties due on a monthly basis.

Solution

The relevant date for balancing payments is 31 January 2025.

No POAs are ever required for CGT.

The amounts due were therefore as follows:

31 January 2025	Income tax (£6,000 – £4,000)	£2,000
	Capital gains tax	£3,000

Interest will run as follows:

Income tax £2,000 from 1 February 2025 to 28 February 2025
 $(1/12 \times 6.5\% \times £2,000) = £11$

CGT £3,000 from 1 February 2025 to 31 March 2025
 $(2/12 \times 6.5\% \times £3,000) = £33$

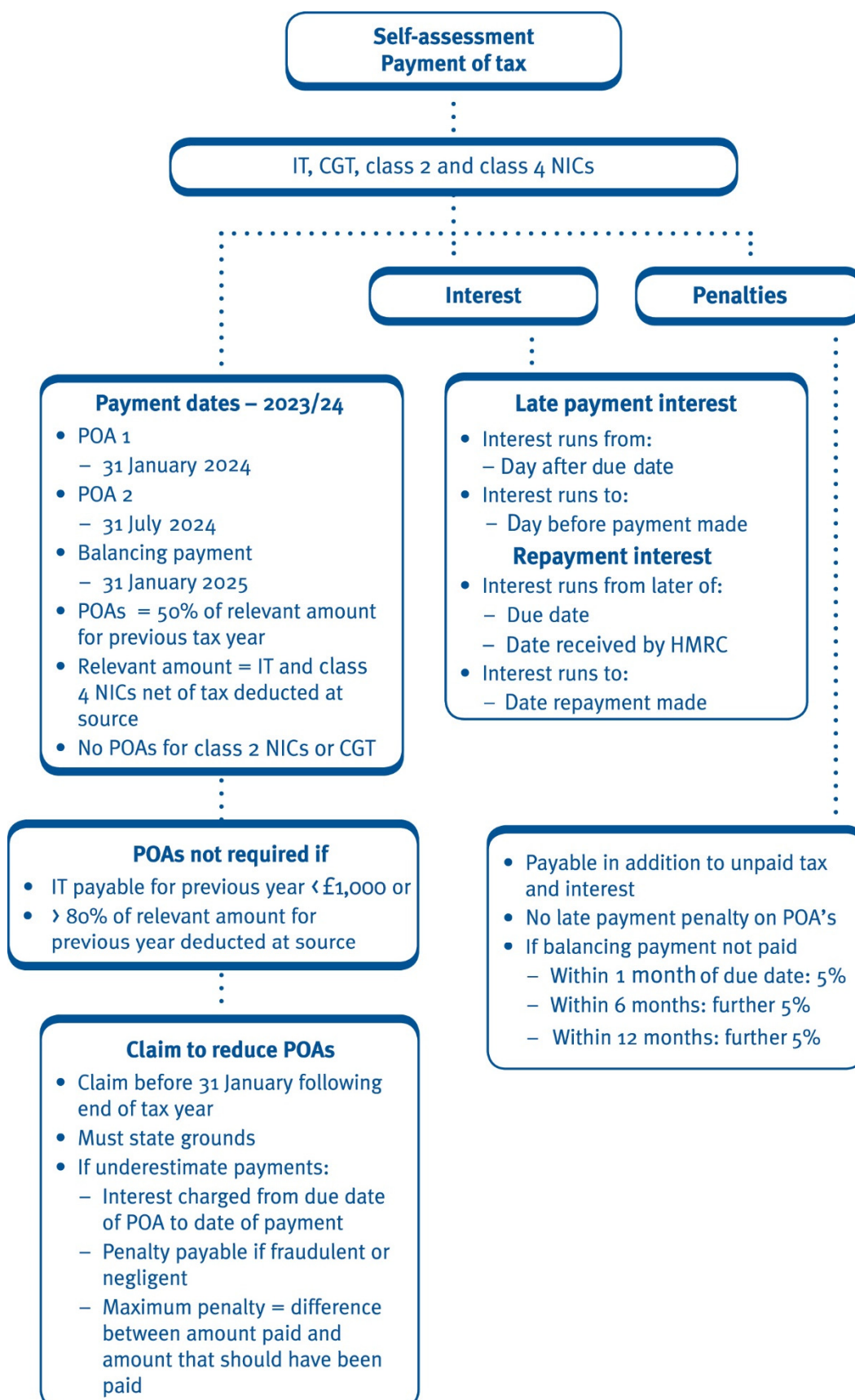
In addition, a penalty is due on the CGT (as it was more than one month late) of 5% of £3,000 = £150.

There is no penalty in respect of the late payment of income tax as it was paid within one month.

Total interest and penalties payable = (£11 + £33 + £150) = £194.

The penalty may be reduced if HMRC accepts there were special circumstances.

4 Summary



5 Records

Taxpayers are required to keep and preserve records necessary to make a correct and complete return.



Records

For a business (including the letting of property), the records that must be kept include:

- all receipts and expenses
- all goods purchased and sold
- all supporting documents relating to the transactions of the business, such as accounts, books, contracts, vouchers and receipts.

Other taxpayers should keep evidence of income received such as:

- dividend vouchers
- P60s
- copies of P11Ds
- bank statements.

Retention periods

For taxpayers with a business (i.e. the self-employed)

- All records (not just those relating to the business) must be retained until **five years after the 31 January filing date**.
- For the tax year 2023/24 records must therefore be retained until 31 January 2030.

For other taxpayers

Records must be retained until the **latest** of:

- 12 months after the 31 January filing date (31 January 2026 for the tax year 2023/24)
- the date on which a compliance check into the return is completed
- the date on which it becomes impossible for a compliance check to be started.

Penalties for not keeping records

A penalty may be charged for failure to keep or retain adequate records.

The maximum penalty is only likely to be imposed in the most serious cases such as where a taxpayer deliberately destroys records in order to obstruct an HMRC compliance check.

See section 7 for the detail on the penalties that may be imposed.

6 Compliance checks

HMRC has the right to enquire into the completeness and accuracy of any self-assessment tax return through its compliance checks.



HMRC compliance checks

HMRC's right of enquiry

- HMRC must give written notice before commencing a compliance check (also known as an enquiry).
- The written notice must be issued within 12 months of the date the return is filed with HMRC. If the return is filed late then notice must be within 12 months from the quarter date (i.e. 30 April, 31 July, 31 October or 31 January) following the date of filing. Once this deadline is passed, the taxpayer can normally consider the self-assessment for that year as final.

The compliance check may be made as a result of any of the following:

- a suspicion that income is undeclared
- deductions being incorrectly claimed
- other information in HMRC's possession
- being part of a random review process.

Additional points:

- HMRC does not have to state a reason for the compliance check and is unlikely to do so.
- A compliance check can be made even if HMRC calculated a taxpayer's tax liability.

Compliance check procedures

HMRC can demand that the taxpayer produces any or all of the following:

- documents
- accounts
- other written particulars
- full answers to specific questions.

The information requested by HMRC should be limited to that connected with the return.

An appeal can be made against the request.

The compliance check ends when HMRC gives written notice that it has been completed. The notice will state the outcome of the enquiry.

The closure notice must include either

- confirmation that no amendments are required
- HMRC's amendments to the self-assessment.

If a taxpayer (or adviser) is found to make false returns, false accounting or forged documents then HMRC may seek a criminal prosecution which could result in imprisonment or an unlimited fine.

At the end of an enquiry the taxpayer may be required to sign a 'certificate of full disclosure'. If this is found to be false then the taxpayer would be liable to criminal prosecution which could result in imprisonment.

The taxpayer has 30 days to appeal against any amendments by HMRC. The appeal must be in writing.



Discovery assessments

HMRC must normally begin compliance checks into a self-assessment return within 12 months of the date the return is filed, however a discovery assessment can be raised at a later date to prevent the loss of tax.

The use of a discovery assessment is restricted where a self-assessment has already been made:

- Unless the loss of tax was brought about carelessly or deliberately by the taxpayer, a discovery assessment cannot be raised where full disclosure was made in the return, even if this is found to be incorrect.
- HMRC will only accept that full disclosure has been made if any contentious items have been clearly brought to its attention – perhaps in a covering letter or in the 'white space' on the tax return.
- Information lying in the attached accounts will not constitute full disclosure if its significance is not emphasised.
- Only a taxpayer who makes full disclosure in the tax return has absolute finality 12 months after the date the return is filed.

The time limit for issuing a discovery assessment is:

	Time from end of tax year	For 2023/24
Basic time limit	Four years	5 April 2028
Careless error	Six years	5 April 2030
Deliberate error	Twenty years	5 April 2044

A discovery assessment may be appealed against.



Information and inspection powers

- HMRC has one set of powers to inspect business records, assets and premises.
- The regime covers all taxes in the ATX syllabus (i.e. income tax, NICs (collected through PAYE), capital gains tax, inheritance tax, stamp taxes, corporation tax and VAT).
- HMRC also has a unified approach, across all taxes, to asking taxpayers for supplementary information, based on formal information notices with a right of appeal.

HMRC can also request information from third parties provided either the taxpayer or the First-tier Tax Tribunal agrees (section 8).

Collection of data from third party bulk data gatherers (e.g. banks, building societies and stockbrokers) is included in these powers.

7 Penalties

Standard penalties

HMRC has standardised penalties across taxes for different offences.

The standard penalty applies to two key areas:

- submission of incorrect returns – all taxes
- failure to notify liability to tax – income tax, CGT, corporation tax, VAT and NICs.

The penalty is calculated as follows, as a percentage of 'potential lost revenue' which is generally the tax unpaid as a result of the error or failure to notify.

Taxpayer behaviour	Maximum penalty	Minimum penalty – unprompted disclosure	Minimum penalty – prompted disclosure
Deliberate and concealed	100%	30%	50%
Deliberate but not concealed	70%	20%	35%
Careless	30%	0%	15%



The above table is provided in the tax rates and allowances in the examination.

An incorrect return:

- must result in an understatement of the taxpayer's liability, and
- no reasonable steps have been taken to notify HMRC of the error.
- Includes:
 - deliberately supplying false information
 - deliberately withholding information
 - inflating a loss and/or claims for allowances and reliefs
 - inflating a tax repayment claim
 - submitting incorrect accounts in relation to a liability.

If there is more than one error in a return, a separate penalty can be charged for each error.

There is no penalty for incorrect returns where a genuine mistake has been made.

Failure to notify liability to tax applies where

- the taxpayer has a liability to tax, and notification is required
- but notification of chargeability is not made to HMRC.

The maximum penalties can be reduced where

- the taxpayer informs HMRC of the error (i.e. makes a disclosure), and
- co-operates with HMRC to establish the amount of tax unpaid
- with larger reductions given for unprompted disclosure.

There are minimum penalties, as shown in the table above, that vary based on

- behaviour
- whether disclosure was prompted or unprompted.

An unprompted disclosure is where a taxpayer:

- makes a disclosure
- when there is no reason to believe that HMRC has, or is about to, discover the error.

An unprompted disclosure of a careless error can reduce the penalty to 0%.

A taxpayer can appeal to the first tier of the tax tribunal against

- a penalty being charged, and
- the amount of the penalty.

Penalties for late filing of returns

Standardised penalties apply for the late filing of tax returns for many taxes. For ATX, in the June 2024, September 2024, December 2024 and March 2025 sittings, these rules apply for individuals only.

Date return is filed	Penalty
<ul style="list-style-type: none"> After due date 3 months late 6 months late More than 12 months after due date where withholding information was: <ul style="list-style-type: none"> not deliberate deliberate but no concealment deliberate with concealment 	<ul style="list-style-type: none"> £100 fixed penalty Daily penalties of £10 per day (maximum 90 days), in addition to £100 fixed penalty 5% of tax due (minimum £300), plus above penalties <p>The above penalties plus:</p> <ul style="list-style-type: none"> Additional 5% of tax due (minimum £300) 70% of tax due (minimum £300) 100% of tax due (minimum £300)

The tax geared penalties for submitting a return more than 12 months late can be reduced by prompted/unprompted disclosure.

Penalties for late payment of tax

Covered in section 3 of this chapter.

Other penalties

Offence	Penalty
Penalty for fraud or negligence on claiming reduced payments on account	<div>£</div> <div>POAs should have paid X</div> <div>Less: POAs actually paid (X)</div> <div>—</div> <div>X</div> <div>—</div>
Failure to keep and retain required records	Up to £3,000 per tax year



Illustration 3 – Penalties

Enzo was issued with a notice to file a tax return in April 2024 which relates to the tax year 2023/24.

Unfortunately, he did not submit his return to HMRC until 10 October 2025. The tax due for the tax year 2023/24 amounts to £175.

Identify the penalties that will be charged in respect of the return.

Solution

A fixed penalty of £100 will be due as the return is not filed by 31 January 2025.

HMRC could also impose daily penalties of £10 for a maximum of 90 days, as the return was more than three months late.

In addition, as the return was more than six months late, a penalty of £300 will be due (as this is more than $5\% \times £175$).

8 Appeals

A taxpayer can appeal against a decision made by HMRC, but must do so within 30 days of the disputed decision.

Most appeals are then settled amicably by discussion between the taxpayer and HMRC.

However, if the taxpayer is not satisfied with the outcome of the discussions, the taxpayer can proceed in one of two ways:

- request that the case is reviewed by another HMRC officer, or
- have the case referred to an independent tax tribunal.

If the taxpayer opts to have the case reviewed but disagrees with the outcome, an appeal to the Tax Tribunal can still be made.

The taxpayer must also apply to postpone all or part of the tax charged. Otherwise the taxpayer will have to pay the disputed amount.



Tax Tribunals

The Tax Tribunal is an independent body administered by the Tribunals Service of the Ministry of Justice. Cases are heard by independently appointed tax judges and/or panel members. Each panel is appointed according to the needs of the case.

There are two tiers (layers) of the Tax Tribunal system:

- First-tier Tribunal, and
- Upper Tribunal.

First-tier Tribunal

The First-tier Tribunal will be the first tribunal for most issues. They deal with:

- | | |
|-----------------------|---|
| • Default paper cases | simple appeals (e.g. against a fixed penalty) – will usually be decided on without a hearing provided both sides agree. |
| • Basic cases | straightforward appeals involving a minimal exchange of paperwork in advance of a short hearing. |
| • Standard cases | appeals involving more detailed consideration of issues and a more formal hearing. |
| • Complex cases | some complex appeals may be heard by the First-tier Tribunal however they will usually be heard by the Upper Tribunal. |

If the dispute is not resolved at the First-tier level, then the appeal can go to the Upper Tribunal.

Upper Tribunal

The Upper Tribunal will mainly, but not exclusively, review and decide appeals from the First-tier Tribunal on a point of law.

In addition, they will also deal with complex cases requiring detailed specialist knowledge and a formal hearing (e.g. cases involving long and complicated issues, points of principle and large financial amounts).

Hearings are held in public and decisions are published.

A decision of the Upper Tribunal may be appealed to the Court of Appeal. However, the grounds of appeal must always relate to a point of law.

**Publication of names of tax offenders**

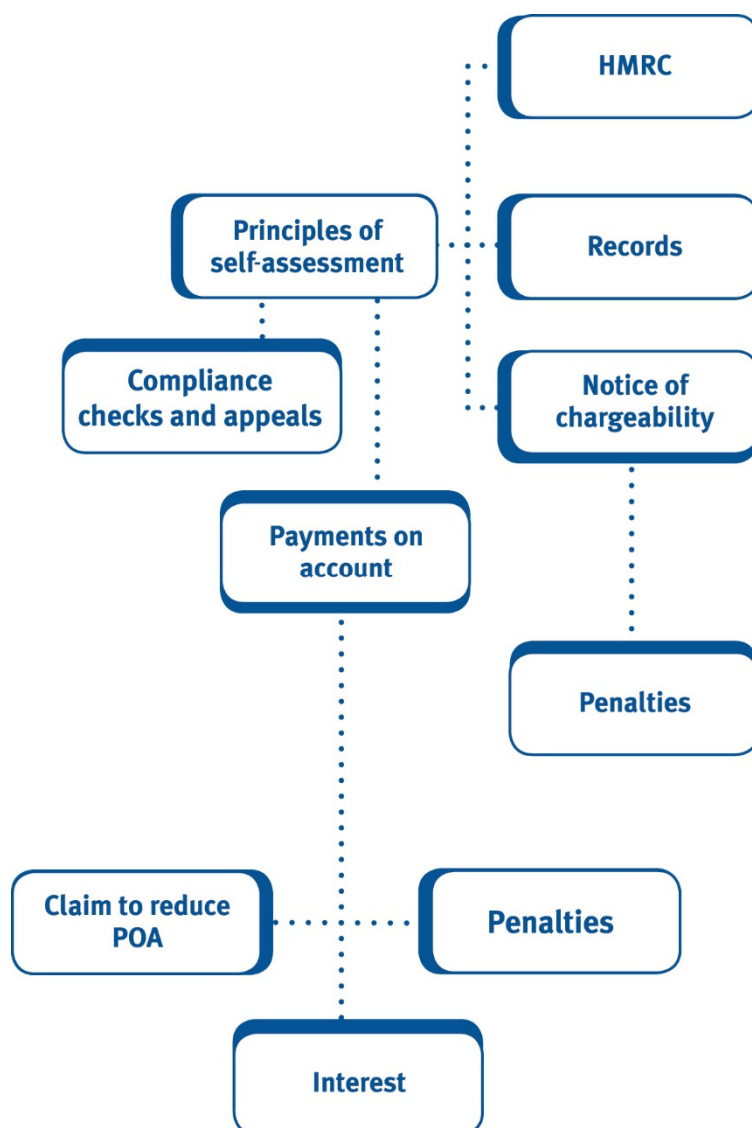
- HMRC has the power to publish the names and details of individuals and companies who are penalised for deliberate defaults leading to a loss of tax of more than £25,000.
- Names will not be published of those who make a full unprompted disclosure or a full prompted disclosure within the required time.

**Monitoring of serious tax offenders**

Those who incur a penalty for deliberate evasion in respect of tax of £5,000 or more will be required to submit returns for up to:

- the following five years
- showing more detailed business accounts information, and
- detailing the nature and value of any balancing adjustments within the accounts.

9 Chapter summary



Test your understanding answers



Test your understanding 1

Rebecca

The balancing payment for the tax year 2023/24 due on 31 January 2025 will be:

	£
Total tax payable	13,726
Less: POAs	(8,000)
	<hr/>
Balancing payment – 2023/24	5,726
	<hr/>

The balancing payment comprises:

	£
Income tax and class 4 NICs (£8,300 + £800 – £8,000)	1,100
Class 2 NICs	179
CGT	4,447
	<hr/>
Balancing payment – 2023/24	5,726
	<hr/>

In addition, the first POA for the tax year 2024/25 will be due on 31 January 2025.

The first POA for the tax year 2024/25 will be 50% of the 'relevant amount' using the 2023/24 position.

	£
2023/24 – income tax payable (after deducting tax at source)	8,300
2023/24 – class 4 NICs	800
	<hr/>
Relevant amount	9,100
	<hr/>

First POA for the tax year 2024/25 = (£9,100 × 50%) = £4,550

Summary

	£
Balancing payment – 2023/24	5,726
First POA – 2024/25	4,550
	<hr/>
Total payable by 31 January 2025	10,276
	<hr/>

Note: Class 2 NICs and CGT have no impact on POAs.

Income tax: Computation

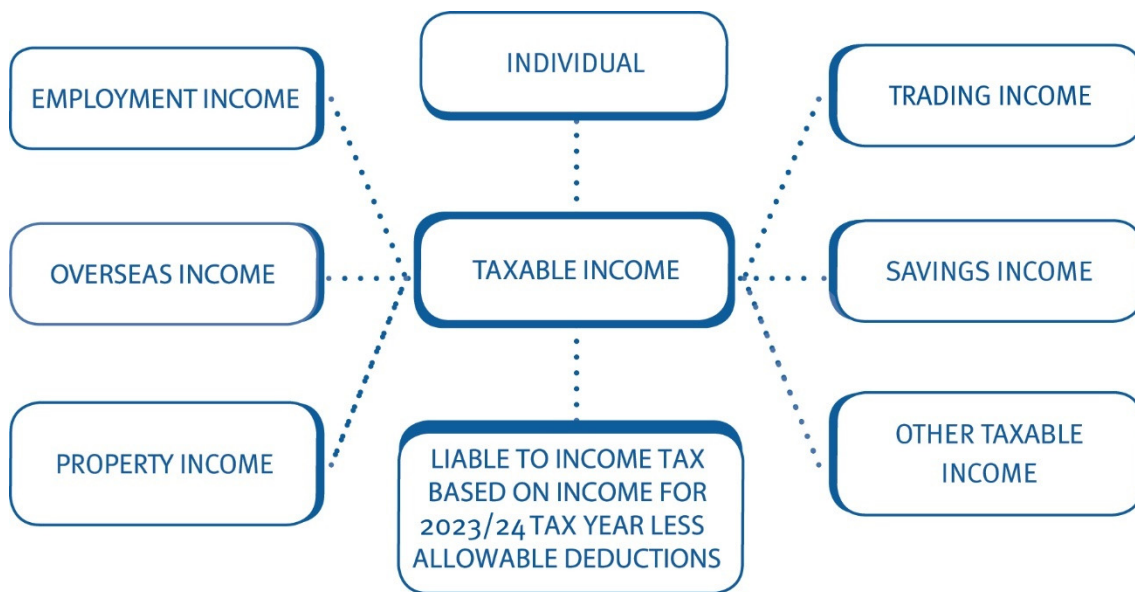
Chapter learning objectives

Upon completion of this chapter you will be able to:

- prepare an income tax computation for an individual given a range of different types of income/payments
- advise on the tax implications of jointly held assets
- recognise the tax treatment of savings income paid net of tax
- understand the allocation of the personal allowance to different categories of income
- advise on the income tax position of the income of minor children



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities, including computations for individuals. Another of the PER performance objectives (PO17) is to advise on mitigating and deferring tax liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.



Introduction

This and the following two chapters deal with the basic charge to income tax and national insurance, concentrating on an employed individual with property and investment income.



Most of the basic rules in this chapter were covered in TX. A reminder of the TX rules is given in supplementary reading and revision examples are provided to check your retention of the required TX knowledge.

1 Income tax computation

Basis of assessment

Income tax is payable on an individual's taxable income for a tax year.

The June 2024, September 2024, December 2024 and March 2025 examinations are based on the tax year 2023/24, which is from 6 April 2023 to 5 April 2024.

Individual taxpayers, married or single, are taxed separately on their own taxable income.

Taxable income

A reminder of the computation of taxable income, the classification of income and the rates of income tax is given in the pro forma income tax computation below.

Pro forma income tax computation

Name of individual

Income tax computation – 2023/24

	Notes	£
Earned income		
Employment income		X
Trading profits		X
Other earned income	1	X
Savings income		
Interest received gross	2	X
Interest received net ($\times 100/80$)	3	X
Investment income		
Property income		X
Other types of investment income	4	X
Dividend income		
Dividends received from UK companies		
Other dividends	5	X
Total income		<u>X</u>
Less: Reliefs	6	
Qualifying loan interest (gross amount paid)		(X)
Loss reliefs		(X)
Net income		<u>X</u>
Less: Personal allowance (PA)	7	(X)
Taxable income		<u>X</u>
		£
Income tax (calculated at relevant rates)	8	X
Less: Marriage allowance (MA)	9	(X)
EIS, SEIS and VCT relief (30%/50%/30%)	10	(X)
Double taxation relief (DTR)	11	(X)
Income tax liability		<u>X</u>
Less: Tax credits	12	(X)
Income tax payable by self-assessment		<u>X</u>

Remember that in the taxable income computation:

- all income is included **gross**
- any exempt income is excluded.

Exempt income

The following income is exempt from income tax:

- income from Individual Savings Accounts (ISAs)
- NS&I savings certificate interest
- interest on repayment of tax
- statutory redundancy payments
- scholarship income
- gaming, lottery and premium bond winnings
- state benefits paid in the event of accident, sickness, disability or infirmity.

Notes to computation:

(1) **Other earned income** includes:

- pensions from former employment
- state pensions
- profits from furnished holiday accommodation (Chapter 18).

(2) **Interest received gross** includes:

- bank and building society interest, gilt-edged security interest, NS&I bank interest, interest from quoted corporate bonds issued by UK resident companies
- overseas interest (gross of overseas tax suffered) (Chapter 20).

(3) **Interest received net** includes:

- interest from unquoted corporate bonds issued by UK resident companies to individuals (e.g. loan note interest)
- interest from an 'interest in possession' (IIP) trust (Chapter 13).

(4) **Other types of investment income** includes:

- annuity income (income element only)
- non-savings income from an IIP trust ($\times 100/80$) (Chapter 13)
- discretionary trust income ($\times 100/55$) (Chapter 13)
- other overseas income (gross of overseas tax suffered) (Chapter 20)
- dividends from a real estate investment trust (REIT) ($\times 100/80$) (Chapter 18).

- (5) **Other dividend income** includes:
- dividends from an IIP trust ($\times 100/91.25$) (Chapter 13)
 - overseas dividends (gross of overseas tax suffered) (Chapter 20).
- (6) **Qualifying loan interest** is covered later in this Chapter. **Loss reliefs** are covered in detail in Chapters 21 and 22.
- The maximum amount allowed to be deducted from total income is the greater of:
- £50,000, or
 - 25% of adjusted total income.
- More detail of the maximum restriction is given in Chapter 21.
- (7) The PA is normally £12,570, but could be abated to £Nil.
- (8) The following **rates of income tax** apply in the tax year 2023/24:

Income level	Band	Non-savings	Savings (see below)	Dividends (see below)
First £37,700	Basic rate (BR)	20%	20%	8.75%
£37,701 – £125,140	Higher rate (HR)	40%	40%	33.75%
£125,141 and over	Additional rate (AR)	45%	45%	39.35%



The above rates of income tax and associated bands are included in the tax rates and allowances provided to you in the examination.

Remember to:

- tax income in the following order:
 - (1) non-savings income
 - (2) savings income
 - (3) dividend income
 - extend the basic rate and higher rate bands by the **gross amount paid** in the tax year of:
 - **personal pension scheme** contributions (PPCs) (Chapter 19), and
 - **gift aid donations**

However, note donations to charity by an individual are not examinable at ATX.
- (9) Subject to conditions, a maximum of £1,260 of the PA can be transferred to a spouse or civil partner (see section 3).
- (10) Relief under EIS, SEIS and VCTs is covered in Chapter 18.

- (11) Double taxation relief (DTR) and the treatment of overseas income is covered in Chapter 20.
- (12) Most types of savings income and all dividend income are received gross with no income tax deducted at source. Therefore, PAYE is the only tax credit that will commonly be deductible to calculate income tax payable.

Rates of tax on savings

- Savings income is normally taxed in the same way as 'non-savings income' at the basic, higher and additional rates of tax (20%, 40% and 45%).
- However, a starting rate of tax of 0% will apply to savings income where it falls into the first £5,000 of taxable income.

In addition, basic rate and higher rate taxpayers are entitled to a savings income nil rate band.

- The savings income nil rate band is:

– Basic rate taxpayer	£1,000
– Higher rate taxpayer	£500
– Additional rate taxpayer	£Nil



The savings income nil rate bands are included in the tax rates and allowances provided to you in the examination.

Savings income is taxed as the next slice of income after non-savings income. Therefore the rates of tax applicable to savings income depend on the level of taxable non-savings income. The procedure to follow is:

- (1) Calculate income tax on non-savings income
- (2) Apply the different rates of tax on savings income in the following order:
 - (i) Starting rate
 - (ii) Savings income nil rate band
 - (iii) Normal rates (i.e. basic, higher and additional rates)

- (i) **Starting rate**

This only applies in fairly limited situations i.e. where taxable non-savings income is less than £5,000. If:

- No taxable non-savings income – the first £5,000 of taxable savings income is taxed at 0% (i.e. it is tax free)
- Taxable non-savings income below £5,000 – savings income falling into the rest of the first £5,000 is taxed at 0%
- Taxable non-savings income in excess of £5,000 – the 0% starting rate is not applicable.

(ii) Savings income nil rate band

If there is further savings income to tax, consider the savings income nil rate band. If the taxpayer is:

- A **basic rate** taxpayer – the next **£1,000** falls in the savings income nil rate band and is taxed at 0%
- A **higher rate** taxpayer – the next **£500** falls in the savings income nil rate band and is taxed at 0%
- An **additional rate** taxpayer i.e. taxable income is £125,140 or more – **not applicable**.

To determine whether the taxpayer is a basic, higher or additional rate taxpayer, ascertain the highest tax band that the taxable income falls within.

For example, a taxpayer with taxable income of £45,000 is a higher rate taxpayer as some taxable income falls into the higher rate band of £37,701 to £125,140.

(iii) Normal rates

If there is further savings income to tax, apply the normal savings rates as follows:

- The basic rate of 20% applies to savings income falling within the basic rate band (BRB) i.e. the first £37,700 of taxable income.
- The higher rate of 40% applies to savings income falling within the higher rate band (HRB) i.e. income in the range £37,701 to £125,140 of taxable income.
- The additional rate of 45% applies to savings income where taxable income exceeds £125,140.

Note that the BRB and HRB are first reduced by non-savings income and savings income that has been taxed at the starting rate and the savings income nil rate.

The above procedure may seem complicated but if you use the columnar layout of the income tax computation (see below) it will be relatively easy to determine which rates to apply.

**Test your understanding 1**

Eugenie received bank interest of £6,000 during the tax year 2023/24.

Calculate Eugenie's income tax payable assuming she also had employment income in the tax year 2023/24 of:

- (a) £15,150 (PAYE of £516 deducted)
- (b) £29,650 (PAYE of £3,416 deducted)
- (c) £46,000 (PAYE of £6,686 deducted)



In the examination always indicate the rate at which income is taxed, even if the rate is 0%. This shows that you understand that the income is taxable and that you know how to apply the different rates.

Rates of tax on dividends

- The first £1,000 of dividend income falls in the dividend nil rate band and is therefore tax-free.
- The following rates of tax apply to any remaining dividend income:

Dividends falling into the:	Dividend rates
Basic rate band (first £37,700)	8.75%
Higher rate band (£37,701 – £125,140)	33.75%
Additional rate band (over £125,140)	39.35%



The rates and thresholds applicable to dividends are included in the tax rates and allowances provided to you in the ATX examination.

Applying the appropriate rates of tax to dividend income

Dividend income is taxed as the top slice of income (i.e. after non-savings income and savings income).

- (1) The dividend nil rate band applies to the first £1,000 of dividend income.
 - (i) Unlike the savings starting rate (which only applies in certain limited circumstances) and the savings income nil rate band (which depends on the tax position of the individual) the dividend nil rate band **always applies** to the first £1,000 of dividend income.
 - (ii) The dividend income taxed at the dividend nil rate reduces the basic rate and higher rate bands when determining the rate of tax on the remaining dividend income.
- (2) Any remaining dividend income is taxed at the special dividend rates set out above.



Illustration 1 – Income tax

Andrei received the following income in the tax year 2023/24:

Employment income £55,000 (PAYE of £9,432 deducted)

Dividends received £6,000

Calculate Andrei's income tax payable for the tax year 2023/24.

Solution

Andrei's income tax payable 2023/24

	Non-savings income	Dividend income	Total
	£	£	£
Employment income	55,000		55,000
Dividend income		6,000	6,000
	<hr/>	<hr/>	<hr/>
Total income	55,000	6,000	61,000
Less: PA	(12,570)		(12,570)
	<hr/>	<hr/>	<hr/>
Taxable income	42,430	6,000	48,430
	<hr/>	<hr/>	<hr/>
Income tax			
Non-savings – basic rate	37,700	× 20%	7,540
Non-savings – higher rate	4,730	× 40%	1,892
	<hr/>		
	42,430		
Dividend income – DNRB	1,000	× 0%	0
Dividend income – higher rate	5,000	× 33.75%	1,688
	<hr/>		
	48,430		
	<hr/>		<hr/>
Income tax liability			11,120
Less: Tax credits			
PAYE			(9,432)
			<hr/>
Income tax payable			1,688
			<hr/>



Test your understanding 2

For the tax year 2023/24, Kei had the following income:

Property income	£40,000
Bank interest	£2,000
Dividends	£10,500

Calculate Kei's income tax liability for the tax year 2023/24.

Qualifying loan interest

A reminder of the types of loan interest qualifying for relief as an allowable deduction in an income tax computation is given below and is summarised in the diagram in section 5.

A maximum deduction restriction applies to these payments and loss relief. However, it is more likely to be examined in the context of losses, therefore the detailed rules are in Chapter 21.



Qualifying loan interest

Relief is given for interest paid on loans incurred to finance expenditure for a qualifying purpose but only interest paid at a reasonable commercial rate. Amounts paid in excess are not allowable.

Note that qualifying loan interest is **paid gross** and the gross amount paid in the tax year is an allowable relief against total income (subject to the maximum deduction).

The main types of qualifying purposes to which the loan must be applied are:

(1) Partnerships

- The contribution of capital into a partnership (including limited liability partnerships).
- A loan made by a partner for the purchase of plant or machinery for use in the partnership – year of purchase and next three years.

(2) Close companies

The purchase of ordinary shares in, or loans to, a 'close' trading company (Chapter 24) or a company in the EEA which would be a 'close' trading company if it were situated in the UK.

The following conditions must be satisfied:

- the individual (with associates) owns at least 5% of the ordinary share capital at the time the interest is paid, or
- the individual owns some shares in the company at the time the interest is paid and, during the period from the purchase of the shares until the payment of the interest, must have worked for the greater part of the time in the actual management of the company, or an associated company.

If the individual has claimed EIS/SEIS relief (Chapter 18) in respect of the share purchase then there will be no relief for the interest.

(3) **Employee-controlled companies**

Relief is available to full-time employees for loans taken out to acquire ordinary shares in an employee-controlled, UK or EEA resident, unquoted trading company.

Again, if the individual has claimed EIS/SEIS relief in respect of the share purchase then there will be no relief for the interest.

(4) **Personal representatives**

The payment of inheritance tax on the deceased's personal estate. Relief is available for one year only.



The treatment of royalties paid by an individual

Patent and copyright royalties payable for trading purposes (calculated on an accruals basis) are an allowable deduction in calculating the adjusted trading profits of a business.

Copyright royalties are paid gross and patent royalties are paid net of the basic rate of income tax (20%).

The collection of the basic rate tax on patent royalties is not examinable.

2 Personal allowances



The personal allowance is included in the tax rates and allowances provided in the examination

Every taxpayer (including children) is entitled to a personal allowance.

- The amount for the tax year 2023/24 is £12,570.
- There is no restriction to the PA where the individual is only alive for part of the tax year (i.e. full allowance available in the tax year of birth or death).

- The basic PA is deducted from the taxpayer's net income from the different sources of income in the most beneficial order. In the majority of cases, this will be:
 - (1) Non-savings income
 - (2) Savings income
 - (3) Dividend income.

However, there are some cases where this will not be the most beneficial order (see below).

Surplus personal allowances are normally lost, they cannot be set against capital gains nor can they be transferred to any other taxpayer.

However, subject to conditions, a maximum of £1,260 of the PA can be transferred to a spouse or civil partner (see section 3).

Reduction of personal allowance – high income individuals

- The basic PA is gradually reduced for individuals with income in excess of £100,000.
- The reduction of the basic PA is based on the taxpayer's adjusted net income (ANI) which is calculated as follows:

	£
Net income	X
Less: Gross gift aid donations (not examinable at ATX)	(X)
Less: Gross personal pension contributions (PPCs)	(X)
	—
Adjusted net income (ANI)	X
	—

- Where the taxpayer's ANI exceeds £100,000, the basic PA is reduced by:
 - **50% × (ANI – £100,000)**
 - If necessary, the reduced PA is rounded up to the nearest pound (although in the examination, rounding up or down is acceptable).
- A taxpayer with ANI in excess of £125,140 will therefore be entitled to no basic PA at all, as the excess above £100,000 is twice the PA.
- The effective rate of tax on income between £100,000 and £125,140 is therefore 60%. This is made up of:
 - higher rate income tax = 40%
 - lost PA ($1/2 \times 40\%$) = 20%
- Taxpayers at or near this margin may therefore wish to consider making additional gift aid or personal pension contributions in order to reduce their ANI below £100,000.



Test your understanding 3

Francesco has an annual salary of £130,000 and made gross personal pension contributions in the tax year 2023/24 of £19,000.

Calculate Francesco's taxable income for the tax year 2023/24.



Test your understanding 4

Matteo earned employment income of £137,700 and received bank interest of £22,300 and dividends of £17,000 in the tax year 2023/24.

Calculate the income tax liability for the tax year 2023/24.

Allocation of the personal allowance

For the majority of individuals it will be most beneficial to deduct the personal allowance (PA) from non-savings income first, then deducting any remaining PA from savings income and finally dividend income.

However, the tax legislation requires the PA to be offset in the most beneficial manner, which may mean deducting the PA from the different sources of income in a different order, for example offsetting the PA against dividend income prior to savings income.

This may be necessary in order to take advantage of the savings income nil rate band, or the starting rate for savings income.



Illustration 2 – Allocation of the personal allowance

Salman has the following income for the tax year 2023/24:

Pension income	£7,570
Savings income	£5,000
Dividend income	£13,000

Calculate Salman's income tax liability for the tax year 2023/24, allocating the personal allowance to the different sources of income in the most beneficial order.

Solution

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Pension income	7,570			7,570
Savings income		5,000		5,000
Dividend income			13,000	13,000
	<hr/>	<hr/>	<hr/>	<hr/>
Total income	7,570	5,000	13,000	25,570
Less: PA	(7,570)		(5,000)	(12,570)
	<hr/>	<hr/>	<hr/>	<hr/>
Taxable income	0	5,000	8,000	13,000
	<hr/>	<hr/>	<hr/>	<hr/>
Income tax				
Savings income – starting rate		5,000	× 0%	0
Dividend income – DNRB		1,000	× 0%	0
Dividend income – basic rate		7,000	× 8.75%	613
		<hr/>		
		13,000		
		<hr/>		<hr/>
Income tax liability				613
				<hr/>

Notes:

- (1) Deducting the personal allowance in the most beneficial manner is automatic and is not a matter of choice or tax planning for the taxpayer.
- (2) The starting rate for savings is available as saving income falls within the first £5,000 of taxable income.

Salman will save £438 by allocating the balance of his PA to dividend income in preference to savings income. This is because £5,000 of income is covered by the starting rate for savings and taxed at 0% rather than being taxed at 8.75% as dividend income (£5,000 × 8.75% = £438).

The income tax computation below shows the income tax liability that would have arisen if the PA was allocated to savings income in preference to dividend income.

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Pension income	7,570			7,570
Savings income		5,000		5,000
Dividend income			13,000	13,000
Total income	7,570	5,000	13,000	25,570
Less: PA	(7,570)	(5,000)		(12,570)
Taxable income	0	0	13,000	13,000
Income tax				
Dividend income – DNRB		1,000	× 0%	0
Dividend income – basic rate		12,000	× 8.75%	1,050
		13,000		
Income tax liability				1,050



Test your understanding 5

Ana has the following income for the tax year 2023/24:

Employment income	£6,800
Savings income	£4,200
Dividend income	£12,000

Calculate Ana's income tax liability for the tax year 2023/24, allocating the personal allowance to the different sources of income in the most beneficial order.

3 The taxation of families

The taxation of married couples

Each spouse in the marriage is taxed separately.

Civil partners (couples registered as a civil partnership) are treated in the same way as married couples.

However, there are special rules governing:

- the allocation of income between the spouses or civil partners where assets are jointly owned
- transfer of unused personal allowance (the marriage allowance).

In addition, married couples and civil partners can transfer income-generating assets between them to minimise their joint income tax liability.

Jointly owned assets

- Generally, income generated from assets owned jointly will be split 50:50 regardless of the actual percentage ownership.
- Where jointly owned assets are held other than in a 50:50 ratio, an election can be made to HMRC for the income to be taxed on the individual partners according to their actual ownership, with the exception of jointly held bank accounts, which are always split 50:50.
- Where the jointly owned asset is shares in a close company, income is automatically taxed on the individual partners according to their actual ownership.

Marriage allowance

A spouse or civil partner can elect to transfer a fixed amount of the PA to the other spouse or civil partner. This is commonly known as the marriage allowance (MA).

The MA is available provided neither spouse or civil partner is a higher rate or additional rate taxpayer.

In practice, however, it will only be beneficial to make the election provided the transferor does not fully utilise the PA of £12,570 but the recipient does, so that their total income tax liability as a couple will be reduced.

Electing for the MA allows the transfer

- to the other spouse or civil partner
- of a fixed amount of PA (regardless of the amount of unused PA)
= £1,260 for the tax year 2023/24.

Note that there is no provision for transferring less than this amount.



The transferable amount of £1,260 will be included in the tax rates and allowances provided to you in the examination.

The effect of the election is that the:

- transferring spouse's or civil partner's PA is reduced by the fixed amount of £1,260 (for 2023/24)
- the recipient spouse's or civil partner's income tax liability is reduced by a maximum of £252 (£1,260 MA × 20% BR income tax).

Note that:

- the transferring spouse or civil partner makes the election
- the relief is given as an income tax reducer in the recipient's income tax liability computation
- the recipient's own PA is not increased
- the maximum benefit from the MA is £252
- if the recipient's income tax liability is less than £252, a tax repayment is not possible but the amount by which the transferor's PA is reduced remains £1,260
- at best the relief reduces the recipient's income tax liability to £Nil
- in the year of marriage, the full allowance is available
- relief is usually given by adjusting the individual's tax code under PAYE (or through self-assessment if the individual is not employed).



Illustration 3 – Marriage allowance

Aljaž and Tala are married. Aljaž is employed and earns a salary of £35,070 per annum. Tala spends most of her time looking after their two children but works on a Saturday, earning an annual salary of £6,000. They do not have any other income.

Tala makes an election to transfer the marriage allowance to Aljaž.

Calculate Aljaž and Tala's income tax liabilities for the tax year 2023/24.

Solution

Income tax computation – 2023/24

	Aljaž £	Tala £
Employment income = net income	35,070	6,000
Less: PA (Note)	(12,570)	(6,000)
	<hr/>	<hr/>
Taxable income	22,500	0
	<hr/>	<hr/>
Income tax liability (£22,500 × 20%)	4,500	0
Less: MA (£1,260 × 20%)	(252)	
	<hr/>	<hr/>
Income tax liability	4,248	0
	<hr/>	<hr/>

Note: Tala's personal allowance is reduced to £11,310 (£12,570 – £1,260).

This is still more than her total income of £6,000, so she has no tax liability.

If one spouse or civil partner has unused PA of \geq £1,260:

- the maximum tax saving of £252 will be achieved, provided the recipient spouse or civil partner has an income tax liability \geq £252.

If one spouse or civil partner has unused PA of $<$ £1,260:

- the fixed amount of £1,260 must still be transferred
- however, the transferring spouse or civil partner will have to pay some tax, and
- the maximum total tax saving for the couple will be
= (unused PA \times BR income tax)



Test your understanding 6

Katie and Emily are civil partners. Katie is a basic rate taxpayer and her only source of income is from self-employment. Emily is studying in the tax year 2023/24 and does not utilise her personal allowance.

Emily makes an election to transfer the marriage allowance to Katie.

Calculate Katie and Emily's income tax liabilities for the tax year 2023/24 assuming they have the following amounts of income:

	Katie	Emily
(a)	£30,000	£Nil
(b)	£12,850	£Nil
(c)	£30,000	£11,750 from part-time employment

To be effective for the tax year 2023/24, the election can be made:

- **in advance**
 - by 5 April 2024
 - the election will remain in force for future tax years, unless
 - the election is withdrawn, or
 - the conditions for relief are no longer met
- **in arrears**
 - by 5 April 2028
(i.e. within four years of the end of the tax year)
 - in this case the election will only apply to the tax year 2023/24 in isolation.



The taxation of children

Income of a child is subject to income tax.

The child has a separate income tax computation.

- The child also has full entitlement to a PA, even in the year of birth.
- If required, returns and claims are completed on behalf of the child by a parent or guardian.

Where the child has received taxed income, a repayment of tax will probably arise.



Income derived from a source set up by a parent (a parental disposition) is:

- taxed on the parent, not the child
- unless
 - the gross income received in the tax year is £100 or less, and
 - the child is under 18 (and unmarried).



Parental disposition

- Where a child under the age of 18 (and unmarried) has investment income that is derived from capital provided by a parent:
 - the income is treated as belonging to the parent (if the parent is still alive), rather than the child
- the capital could be provided by:
 - setting up a formal trust or settlement, or
 - a gift of money (e.g. opening a bank account in the child's name) or shares
- if the gross income does not exceed £100 in the tax year, then it is not taxed on the parent and is taxed as the child's income.

Comprehensive example – taxation of families

**Test your understanding 7**

Kate has the following income, outgoings and allowances for the year ended 5 April 2024. She is married to Norman.

	£
Salary	41,550
Benefits, taxable as employment income	1,875
Allowable expenses of employment	(95)
Bank interest	2,650
Building society interest	2,115
Interest from an ISA account	500

Norman and Kate have a son, Mathis, aged 10. Mathis was given £5,000 of 3.5% gilts on 6 April 2023 as a birthday present by Kate.

On 15 November 2023 Norman and Kate jointly bought a property that has been let out as unfurnished accommodation. The taxable property income for the tax year 2023/24 is £4,100. No declaration has been made in respect of this source of income.

Calculate Kate's income tax liability for the tax year 2023/24.

4 Income tax planning scenarios

This section considers some possible examination scenarios where you should consider basic income tax planning techniques.

Maximising use of allowances

Individuals should ensure they use their personal allowance and nil rate bands as fully as possible, for example:

- Increasing their non-savings income in order to fully utilise their PA, if their savings and/or dividend income is going to be fully taxed at 0%. They could do this by withdrawing more from a pension scheme or generating more earned income or property income.
- Taking advantage of the savings and dividend nil rate bands if they have significant investment income.
- Shareholders of owner-managed businesses may wish to extract £1,000 of profits as dividends to take advantage of the dividend nil rate band. This will be more tax-efficient than extracting profits as further salary/bonus which would be subject to income tax and national insurance.

Married couples and civil partners

Married couples and civil partners should consider the following techniques:

- equalising income and maximising use of nil rate bands
- using tax-free investments
- maximising pension contributions.

Equalisation of income

Spouses or civil partners are taxed separately. They may choose to own assets in sole ownership or jointly.

The income from jointly owned assets is taxed in equal shares. Where the underlying ownership of the asset is not equal an election can be made to apportion the income using the proportion in which the investment is owned, with the exception of joint bank accounts, which are always taxed 50:50.

In addition, such couples can transfer income-generating assets between them, at no tax cost, to minimise their joint tax liability.

In particular, such couples should aim to utilise where possible both individuals':

- personal allowances
- starting rate bands
- savings and dividend nil rate bands
- basic rate bands.

If one of the couple is a basic rate taxpayer and the other is a higher rate/additional rate taxpayer, the couple should aim to utilise the basic rate taxpayer's savings income nil rate band of £1,000, which will be higher than the nil rate band available to the higher rate (£500) or additional rate (£Nil) taxpayer.

The dividend nil rate band is £1,000 regardless of the amount of income an individual has. However, if one of the couple has dividend income in excess of £1,000 that taxpayer may wish to transfer some shares to the other to utilise the other's dividend nil rate band.

Remember these rules and advice only apply to married couples or partners within a civil partnership.

It may also be possible to make a marriage allowance election to transfer a fixed amount of the personal allowance from one spouse or civil partner to the other.



It is important to recognise that the transfer of the interest in the asset to the spouse or civil partner must be a genuine gift to be effective for income tax purposes. There is no immediate CGT/IHT implication.



Illustration 4 – Equalisation of income

Kyria and Spence are a married couple. In the tax year 2023/24 Kyria had earned income of £2,000 and Spence £46,500.

They own a property in joint names but the cost was provided 80% by Spence and 20% by Kyria.

A declaration is in force to support the ownership percentage. The annual income from the property is £20,000.

In addition, they also have a joint investment bank account with a cash balance of £35,000 that earns interest of £800 gross per annum.

Calculate the taxable income for Kyria and Spence respectively and advise them of any income tax planning measures they should consider to reduce their liabilities for the future.

Solution

	Kyria £	Spence £
Earned income	2,000	46,500
Investment income	400	400
Property income (20:80)	4,000	16,000
	<hr/>	<hr/>
Total income	6,400	62,900
Less: PA (restricted)	(6,400)	(12,570)
	<hr/>	<hr/>
Taxable income	0	50,330
	<hr/>	<hr/>

Tax planning

Kyria has unused PA, and basic rate band, whilst Spence is a higher rate tax payer with £12,630 (£50,330 – £37,700) taxed at 40%.

The marriage allowance cannot be used as Spence is a higher rate taxpayer.

Spence will not pay income tax on his investment income as he is entitled to a £500 savings income nil rate band. There is therefore no benefit in transferring this income to Kyria.

The following could be considered

- Transfer of a larger percentage ownership of the property to Kyria.
- Payments into a pension.

Effect

- A transfer of a larger percentage of the property to Kyria would save Spence tax at 40% and enable Kyria's surplus personal allowance and 20% basic rate tax band to be utilised.
- Even with the extra property income, Kyria would remain a basic rate taxpayer, so her savings income of £400 would still be covered by the £1,000 savings income nil rate band (or possibly the £5,000 0% starting rate band, if Kyria's taxable non-savings income remained below £5,000).
- In Spence's case, any pension contributions would provide tax relief at 40% for contributions above the basic rate band.

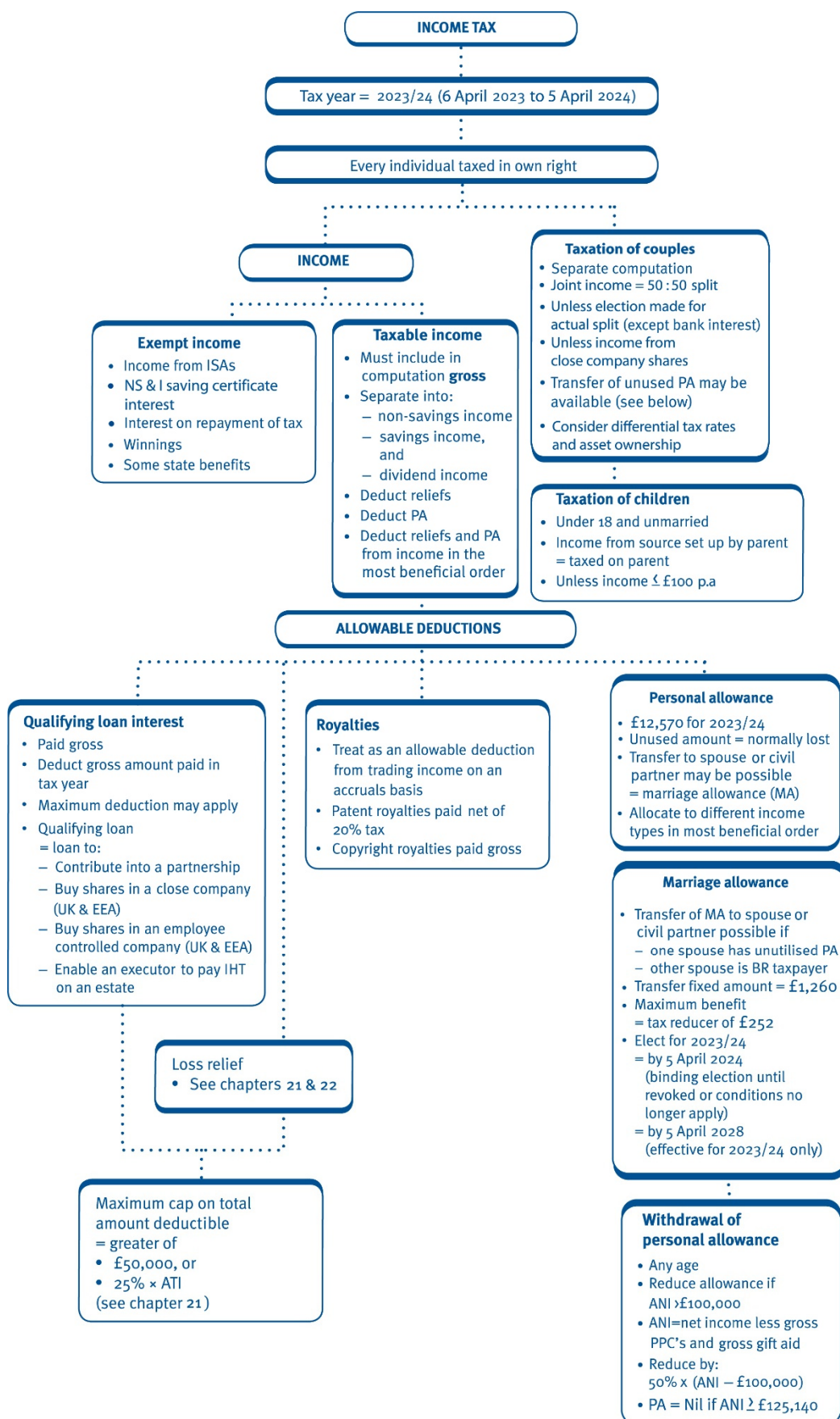
**Test your understanding 8**

Stan and Jie are a married couple. For the tax year 2023/24 they expect to have the following income:

Stan	£	Jie	£
Employment income	170,000	Employment income	20,000
Savings income	2,000	Savings income	0
Dividend income	0	Dividend income	3,000

Advise the couple of any beneficial tax planning measures they should make to minimise their combined income tax liabilities.

5 Chapter summary



Test your understanding answers



Test your understanding 1

Income tax computation – 2023/24

(a) Employment income of £15,150

	Non-savings income	Savings income	Total
	£	£	£
Employment income	15,150		15,150
Bank interest		6,000	6,000
	<hr/>	<hr/>	<hr/>
Total income	15,150	6,000	21,150
Less: PA	(12,570)		(12,570)
	<hr/>	<hr/>	<hr/>
Taxable income	2,580	6,000	8,580
	<hr/>	<hr/>	<hr/>
Income tax			
Non-savings – basic rate	2,580	× 20%	516
Savings income – starting rate	2,420	× 0%	0
	<hr/>		
	5,000		
Savings income – SNRB	1,000	× 0%	0
Savings income – basic rate	2,580	× 20%	516
	<hr/>		
	8,580		
	<hr/>		<hr/>
Income tax liability			1,032
Less: Tax credits			
PAYE			(516)
			<hr/>
Income tax payable			516
			<hr/>

Notes:

- (1) The starting rate applies to £2,420 of the savings income as it falls within the first £5,000 of taxable income.
- (2) Eugenie is a basic rate taxpayer as her taxable income (£8,580) is less than £37,700. Her savings income nil rate band is therefore £1,000.

(b) Employment income of £29,650

	Non-savings income	Savings income	Total
	£	£	£
Employment income	29,650		29,650
Bank interest		6,000	6,000
	<hr/>	<hr/>	<hr/>
Total income	29,650	6,000	35,650
Less: PA	(12,570)		(12,570)
	<hr/>	<hr/>	<hr/>
Taxable income	17,080	6,000	23,080
	<hr/>	<hr/>	<hr/>
Income tax			
Non-savings – basic rate	17,080	× 20%	3,416
Savings income – SNRB	1,000	× 0%	0
Savings income – basic rate	5,000	× 20%	1,000
	<hr/>		
	23,080		
	<hr/>		<hr/>
Income tax liability			4,416
Less: Tax credits			(3,416)
PAYE			<hr/>
Income tax payable			1,000
			<hr/>

Notes:

- (1) The starting rate does not apply as savings income does not fall within the first £5,000 of taxable income.
- (2) Eugenie is a basic rate taxpayer as her taxable income (£23,080) is less than £37,700. Her savings income nil rate band is therefore £1,000. The balance of her savings income of £5,000 (£6,000 – £1,000) is taxed at the basic rate.

(c) Employment income of £46,000

	Non-savings income	Savings income	Total
	£	£	£
Employment income	46,000		46,000
Bank interest		6,000	6,000
	<hr/>	<hr/>	<hr/>
Total income	46,000	6,000	52,000
Less: PA	(12,570)		(12,570)
	<hr/>	<hr/>	<hr/>
Taxable income	33,430	6,000	39,430
	<hr/>	<hr/>	<hr/>
Income tax			
Non-savings – basic rate	33,430	× 20%	6,686
Savings income – SNRB	500	× 0%	0
Savings income – basic rate	3,770	× 20%	754
	<hr/>		
	37,700		
Savings income – higher rate	1,730	× 40%	692
	<hr/>		
	39,430		
	<hr/>		<hr/>
Income tax liability			8,132
Less: Tax credits			
PAYE			(6,686)
			<hr/>
Income tax payable			1,446
			<hr/>

Notes:

Taxable savings income falling in the starting rate band or savings income nil rate band reduces the basic rate band of £37,700.



Test your understanding 2

Kei Income tax liability – 2023/24

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Property income	40,000			40,000
Bank interest		2,000		2,000
Dividend income			10,500	10,500
	<hr/>	<hr/>	<hr/>	<hr/>
Total income	40,000	2,000	10,500	52,500
Less: PA	(12,570)			(12,570)
	<hr/>	<hr/>	<hr/>	<hr/>
Taxable income	27,430	2,000	10,500	39,930
	<hr/>	<hr/>	<hr/>	<hr/>
Income tax				
Non-savings – basic rate		27,430	× 20%	5,486
Savings income – SNRB		500	× 0%	0
Savings income – basic rate		1,500	× 20%	300
Dividend income – DNRB		1,000	× 0%	0
Dividend income – basic rate		7,270	× 8.75%	636
		<hr/>		
		37,700		
Dividend income – higher rate		2,230	× 33.75%	753
		<hr/>		
		39,930		
		<hr/>		
				<hr/>
Income tax liability				7,175
				<hr/>

Notes:

Taxable savings income falling in the savings income nil rate band reduces the basic rate band of £37,700.



Test your understanding 3

Francesco

Taxable income computation – 2023/24

	£
Employment income = total income	130,000
Less: PA (W)	(7,070)
	<hr/>
Taxable income	122,930
	<hr/>

Working: Adjusted PA

	£	£
Basic personal allowance		12,570
Net income (Note)	130,000	
Less: Gross pension contributions (PPCs)	(19,000)	
	<hr/>	
Adjusted net income	111,000	
Less: Income limit	(100,000)	
	<hr/>	
	11,000	
	<hr/>	
Reduction of PA (50% × £11,000)		(5,500)
		<hr/>
Adjusted PA		7,070
		<hr/>

Note: In this question, as there are no other sources of income and no reliefs:

Employment income = total income = net income.

The question only requires the taxable income figure, not income tax payable.



Test your understanding 4

Matteo

Income tax computation – 2023/24

	Non-savings Income	Savings Income	Dividend Income	Total
	£	£	£	£
Employment income	137,700			137,700
Savings		22,300		22,300
Dividends			17,000	17,000
Total income	137,700	22,300	17,000	177,000
Less: PA (Note)	0			0
Taxable income	137,700	22,300	17,000	177,000
Income tax				
Non-savings – basic rate		37,700 × 20%		7,540
Non-savings – higher rate		87,440 × 40%		34,976
		125,140		
Non-savings – additional rate		12,560 × 45%		5,652
		137,700		
Savings income – additional rate		22,300 × 45%		10,035
Dividend income – DNRB		1,000 × 0%		0
Dividend income – additional rate		16,000 × 39.35%		6,296
		177,000		
Income tax liability				64,499

Note: As total income = net income = ANI, and this exceeds £125,140 (£100,000 plus more than double the PA), the PA is reduced to £Nil.



Test your understanding 5

Ana

Income tax computation 2023/24

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Employment income	6,800			6,800
Savings income		4,200		4,200
Dividend income			12,000	12,000
Total income	6,800	4,200	12,000	23,000
Less: PA	(6,800)		(5,770)	(12,570)
Taxable income	0	4,200	6,230	10,430
Income tax				
Savings income – starting rate		4,200 × 0%		0
Dividend income – DNRB		1,000 × 0%		0
Dividend income – basic rate		5,230 × 8.75%		458
		10,430		
Income tax liability				458

Notes:

The PA is deducted from dividend income in preference to savings income to utilise the starting rate for savings, whilst still fully utilising the dividend nil rate band.

Ana will save £368 by allocating her PA to dividend income in preference to savings income. This is because £4,200 of income is covered by the starting rate for savings and taxed at 0% rather than being taxed at 8.75% as dividend income ($£4,200 \times 8.75\% = £368$).



Test your understanding 6

Katie and Emily

(a) Income tax computation – 2023/24

	Katie £	Emily £
Trading income = net income	30,000	0
Less: PA	(12,570)	(0)
	<hr/>	<hr/>
Taxable income	17,430	0
	<hr/>	<hr/>
Income tax liability (£17,430 × 20%)	3,486	0
Less: MA (£1,260 × 20%)	(252)	
	<hr/>	<hr/>
Income tax liability	3,234	0
	<hr/>	<hr/>

Note: All of Emily's PA is unused.

Maximum benefit of election = £252.

(b) Income tax computation – 2023/24

	Katie £	Emily £
Trading income = net income	12,850	0
Less: PA	(12,570)	(0)
	<hr/>	<hr/>
Taxable income	280	0
	<hr/>	<hr/>
Income tax liability (£280 × 20%)	56	0
Less: MA (£1,260 × 20%) restricted	(56)	
	<hr/>	<hr/>
Income tax liability	0	0
	<hr/>	<hr/>

Note: All of Emily's PA is unused.

Maximum benefit of election = restricted as Katie's income is not sufficient to obtain the full benefit.

(c) **Income tax computation – 2023/24**

	Katie £	Emily £
Trading income = net income	30,000	11,750
Less: PA	(12,570)	(11,310)
	<hr/>	<hr/>
Taxable income	17,430	440
	<hr/>	<hr/>
Income tax liability (£17,430 × 20%)	3,486	
(£440 × 20%)		88
Less: MA (£1,260 × 20%)	(252)	
	<hr/>	<hr/>
Income tax liability	3,234	88
	<hr/>	<hr/>

Note: Only £820 (£12,570 – £11,750) of Emily's PA is unused, however if the election is made, the fixed amount of £1,260 must be transferred.

The couple's total income tax liability would be:

With the election £3,322 (£3,234 + £88)

Without the election £3,486

Tax saving from the election = (£3,486 – £3,322) = £164

Alternative calculation = (£820 unused PA × 20%) = £164

**Test your understanding 7****Kate****Income tax computation – 2023/24**

	£	£
Employment income (£41,550 + £1,875 – £95)		43,330
Bank interest	2,650	
Building society interest	2,115	
Gilt interest (Note 1) (3.5% × £5,000)	175	
Interest from an ISA account (exempt)	0	
	<hr/>	4,940
Property income (Note 2)		2,050
		<hr/>
Total income		50,320
Less: PA		(12,570)
		<hr/>
Taxable income		37,750
		<hr/>

Analysis of income:

Dividends	Savings	Non-savings income		
£0	£4,940	(£37,750 – £4,940) = £32,810		
Income tax				
		£		£
Non-savings income – basic rate		32,810	× 20%	6,562
Savings income – SNRB		500	× 0%	0
Savings income – basic rate		4,390	× 20%	878
		<hr/>		
		37,700		
Savings income – higher rate		50	× 40%	20
		<hr/>		
		37,750		
		<hr/>		
Income tax liability				<hr/> 7,460

Notes:

- (1) The gilt interest is taxed on Kate because her son is under 18 and unmarried and the income is derived from capital provided by the parent, and the income is more than £100 in the tax year.
- (2) The property income, being joint income, is divided between Norman and Kate on a 50:50 basis ($£4,100 \div 2 = £2,050$).
- (3) Kate is entitled to a savings income nil rate band (SNRB) of £500 as she is a higher rate taxpayer. The SNRB reduces the basic rate band.

**Test your understanding 8****Stan and Jie – income tax planning measures**

Stan is an additional rate taxpayer, so he is not entitled to a savings income nil rate band (SNRB). His savings income will be subject to income tax at a rate of 45%. Jie is a basic rate taxpayer, and is currently not utilising her £1,000 SNRB. Stan should transfer his savings to Jie; £1,000 would be taxed at 0% (SNRB) and the remaining £1,000 would be taxed at 20% (basic rate), saving tax of £700 ($(£1,000 \times 45\%) + (£1,000 \times (45\% - 20\%))$).

Jie has fully utilised her dividend nil rate band (DNRB) of £1,000. Her dividend income in excess of this will be taxed at 8.75%. She should transfer sufficient shares to Stan to generate dividend income of £1,000. This income would be taxed at 0% as it would be covered by Stan's DNRB and would save tax of £88 ($£1,000 \times 8.75\%$).

Employment income and related NICs

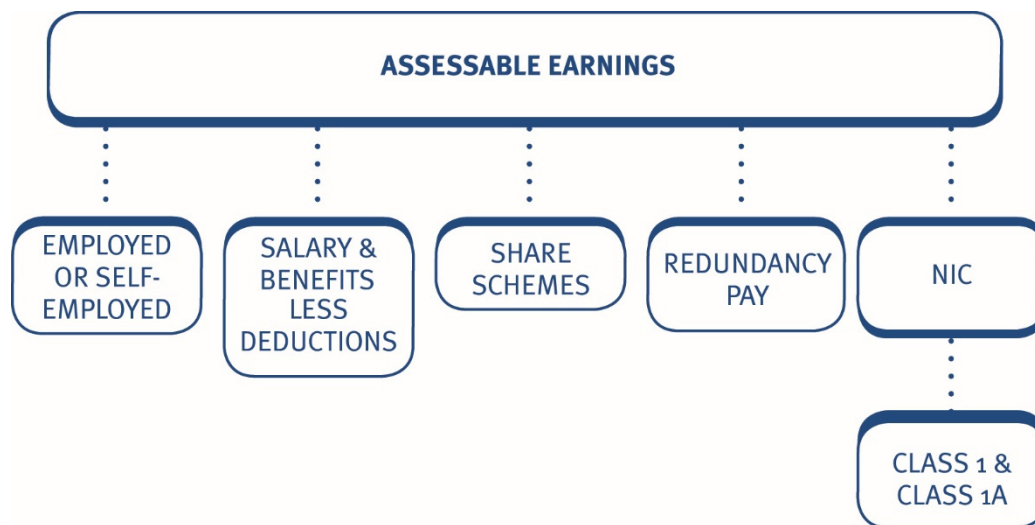
Chapter learning objectives

Upon completion of this chapter you will be able to:

- advise on the tax treatment of share option and share incentive schemes
- advise on the tax treatment of lump sum receipts
- recognise the factors that determine whether an engagement is treated as employment or self-employment and state the differences in the tax treatment
- given details of a remuneration package calculate the taxable employment income, taking into account any allowable deductions
- explain when reimbursed expenses are exempt
- summarise the different classes of national insurance relevant to employers and employees and calculate amounts due.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. This includes calculating taxable employment income which is covered by this chapter. Working through this chapter should help you understand how to demonstrate that objective.



Introduction



This chapter is mainly a revision of the income tax implications of being employed that are covered in TX.

A brief reminder of TX content is given in supplementary reading and revision examples are provided to check your retention of the required TX knowledge.

The main new topics introduced are the tax implications of shares schemes and the treatment of termination payments.

1 Employment status

The distinction between employment and self-employment is fundamental

- an employee is taxable under the employment income provisions
- a self-employed person is taxed on the profits derived from a trade, profession or vocation under the rules governing trading income.

HMRC look at various factors, laid down by statute and case law decisions, to decide whether an individual is employed or self-employed.

The factors considered to determine employment or self-employment status are frequently examined.

Factors of employment or self-employment

The primary test to consider is the nature of the contract that exists:

- Employment contract of service
- Self-employment contract for services.

However, even in the absence of a contract of service the following factors would be taken into account when deciding whether an employment exists:

- **Obligation** by the 'employer' to offer work and the 'employee' to undertake the work offered. An 'employee' would not normally be in a position to decline work when offered.
- **Control** the manner and method of the work being controlled by the 'employer'.
- **Fixed hours** the 'employee' being committed to work a specified number of hours at certain fixed times.
- **Integration** the work performed by the 'employee' is an integral part of the business of the 'employer' and not merely an accessory to it.
- **Risk** the economic reality of self-employment is missing (namely the financial risk arising from not being paid an agreed, regular remuneration).
- **Equipment** the use of equipment can be a useful factor in determining 'employee' status.
- **Rights** if the person has rights under employment legislation, or has the right to receive regular remuneration, holiday pay, redundancy pay or benefits.
- **Source of work** how many different sources of income the individual has.
- **Substitutes** 'employees' must perform the work themselves and cannot send a substitute or hire extra help.

Consequences of status

The tax status of an individual is very important in determining how earnings are taxed. A summary of the key differences is set out below.

	Self-employed	Employee
Income tax	<ul style="list-style-type: none"> • Trading profits: current year basis • Expenses: 'wholly and exclusively' 	<ul style="list-style-type: none"> • Employment income: receipts basis • Expenses: 'wholly exclusively and necessarily'
Payment of income tax	<ul style="list-style-type: none"> • Self-assessment 	<ul style="list-style-type: none"> • Monthly – PAYE
NICs	<ul style="list-style-type: none"> • Class 2 – flat weekly rate • Class 4 – based on profits 	<ul style="list-style-type: none"> • Employee's class 1 – based on cash earnings

Payment of NICs	<ul style="list-style-type: none"> Class 2 and 4 – with income tax under self-assessment 	<ul style="list-style-type: none"> Monthly – PAYE
Pensions	<ul style="list-style-type: none"> Personal pension scheme 	<ul style="list-style-type: none"> Occupational pension scheme and/or, Personal pension scheme
VAT	<ul style="list-style-type: none"> Register Reclaim input VAT 	<ul style="list-style-type: none"> Suffer input VAT

2 Calculation of employment income

Pro forma – Employment income computation

	£	£
Salary		X
Bonus/Commission		X
Benefits		X
Reimbursed expenses		X
Cash vouchers		X
		<hr/>
		X
Less: Allowable deductions		
– Expenses incurred wholly, exclusively, necessarily		(X)
– Contributions to employer's pension scheme		(X)
– Subscriptions to professional bodies		(X)
– Charitable donations: payroll deduction scheme		(X)
– Travel and subsistence expenses		(X)
– Deficit on mileage allowance		(X)
– Cost of partnership shares acquired in a tax advantaged SIP		(X)
		<hr/>
		X
Add: Redundancy payment	X	
Less: Exemption	(X)	
	<hr/>	
Add: Non-tax advantaged share option plan on exercise		X
		<hr/>
Employment income		X
		<hr/>

Basis of assessment

Directors and employees are taxed on the amount of earnings received in the tax year (the **receipts basis**).

Earnings

The term 'earnings' includes cash wages or salary, bonuses, commission and benefits made available by the employer.



Earnings

State benefits

The following state benefits are subject to income tax:

- Statutory sick pay (SSP).
- Statutory maternity pay (SMP).
- Retirement pension and bereavement benefits.

Earnings can include amounts paid for services rendered in the past or to be rendered in the future.

'Golden hellos'

- A payment made to induce an individual to enter into employment will be taxable unless it represents compensation paid for giving up something received under the individual's previous employment in order to enter into the current employment.

Third party payments

Payments made by persons other than the employer if they relate to the provision of services. This would include, for example, tips received by a taxi-driver or waiter.

'Golden handshakes' and restrictive covenant payments

- A payment made to an employee in return for an undertaking to restrict his, her or their activities. An example would be where the employee agrees not to work for a competitor within a set period of time after leaving the current employment.



The receipts basis

The date of receipt is the earlier of:

- the actual date of payment, or
- the date the individual becomes entitled to the payment.

In the case of directors who are in a position to manipulate the timings of payments there are extra rules.

They are deemed to receive earnings on the **earliest** of four dates:

- the actual date of payment
- the date the individual becomes entitled to the payment
- when sums on account of earnings are credited in the accounts
- where the earnings are determined:
 - before the end of a period of account
= the end of that period
 - after the end of a period of account
= date the earnings are determined.



Test your understanding 1

Yasmeen, a director of RIK Ltd, received a bonus of £25,000 on 1 September 2023.

The bonus related to the results of the company for the year ended 31 March 2023. It was credited to Yasmeen in the accounts on 15 July 2023 following a board meeting on 30 June 2023.

Advise when the bonus is taxable as employment income.

Allowable deductions

The general rule is that expenditure will only be deductible if it is incurred **wholly, exclusively and necessarily in the performance** of the duties.

The other types of allowable expenditure shown in the pro forma computation are specifically permitted by statute law.

A reminder of the rules for travel expenses and the mileage allowance deduction is given in supplementary reading and is summarised in the diagram below.



The receipts basis

Travelling expenses may be deducted only where they:

- are incurred necessarily in the performance of the duties of the employment, or
- are attributable to the necessary attendance at any place by the employee in the performance of the employee's duties.

Relief is not given for the cost of journeys that are ordinary commuting or for the cost of private travel.

- Ordinary commuting is the journey made each day between home and a permanent workplace.
- Private travel is a journey between home and any other place that is not for the purposes of work.

Relief is given where an employee travels directly from home to a **temporary** place of work.

A temporary workplace is defined as one where an employee goes to perform a task of limited duration, or for a temporary purpose.

- However, a place of work will not be classed as a temporary workplace where an employee works there continuously for a period that lasts, or is expected to last, more than 24 months.

Where an employee passes the normal permanent workplace on the way to a temporary workplace, relief will still be available provided the employee does not stop at the normal workplace, or any stop is incidental (e.g. to pick up some papers).

Where an employee's business journey qualifies for relief, then the amount of relief is the full cost of that journey. There is no need to take account of any savings the employee makes by not having to make the normal commuting journey to work.



Approved mileage allowance payments

Employees who use their own vehicles for work will normally be paid a mileage allowance.

There are approved mileage allowance payment (AMAP) rates set by HMRC as follows:

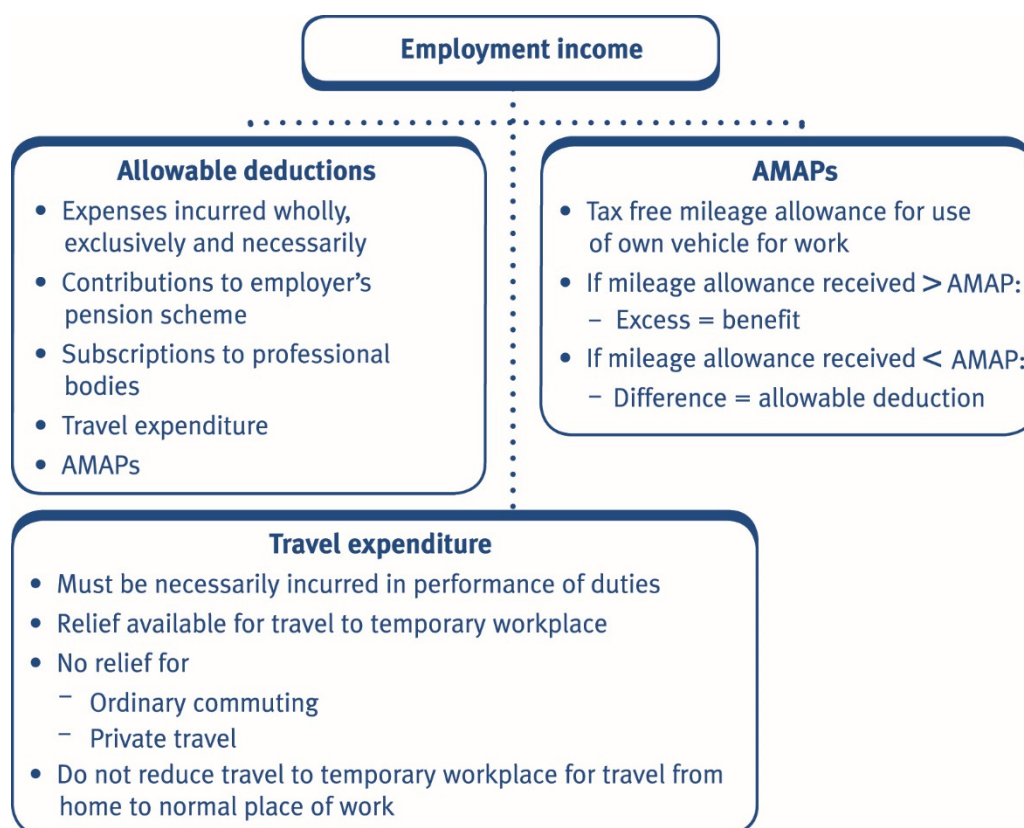
Cars and vans	
First 10,000 miles p.a.	45p
Over 10,000 miles p.a.	25p
Passenger rate	5p
Motorcycles	24p
Bicycles	20p

- The car and van rates are given in the examination, but not the other rates.
- Provided the mileage allowance received is within these rates, no taxable benefit arises.
- Where the mileage allowance received is

	Effect on employment income:
> AMAP rates	Excess = taxable benefit
< AMAP rates, or no allowance received	Difference = allowable deduction

- However, no deduction claim is allowed for any shortfall on the passenger rate where less than 5p a mile is paid.

Summary





Test your understanding 2

Lotte uses her own car for business purposes for which her employer pays an agreed allowance. Lotte drives 12,000 business miles in the tax year 2023/24.

Lotte took a work colleague on some business trips totalling 5,000 miles for which she received an extra 4p per mile from her employer.

Calculate the taxable benefits on Lotte, or the mileage expenses claims, for the tax year 2023/24 assuming Lotte's employer pays a mileage allowance for the car of:

(a) 20p per mile or (b) 50p per mile.

3 Reimbursement of expenses by employers

Where an employee is reimbursed expenses by the employer, the amount received is taxable income. However, an exemption applies where the employee would be able to claim a tax deduction for the business-related expenses under the rules set out above e.g. business travel, professional subscriptions, expenses which fall within the wholly, exclusively and necessarily provisions.

Where an expense is partly allowable and partly disallowable, then the exemption can be applied to the allowable part. For example, where an employee's home telephone bill is fully reimbursed, the exemption can be applied to the business calls, but not to the private calls and the line rental.

Reimbursed expenses which are not exempt must be reported to HMRC using a form P11D and included on the employee's tax return.

4 Employment benefits



The benefit rules were covered in detail at TX. This section provides a reminder of the key rules that need to be retained for ATX.

Employment benefits can be divided into two categories:

- Exempt benefits
- Taxable benefits.

Exempt benefits

A reminder of the rules relating to the types of exempt benefits is given below and the examples include some exempt benefits to check your retention of the required TX knowledge.



Exempt benefits

- Non-cash trivial benefits costing up to £50.
- Employer's contribution to a registered pension scheme.
- Pensions advice up to £500 per employee per tax year for pension advice either provided by the employer or as reimbursement of costs incurred by an employee. The support must be available to all employees or all employees of a certain category, e.g. all employees nearing retirement.
- Medical treatment up to £500 per employee per tax year to help the employee return to work.
- Subsidised canteen, unless part of a salary sacrifice scheme.
- Car parking space.
- Provision of work buses, bicycles, subsidies for public transport.
- One mobile phone per employee (including smart phones).
- Work related training provided by employer.
- In-house sports and recreational facilities.
- Staff parties of up to £150 p.a. per employee.
- Entertainment from a third party to generate goodwill and gifts from a third party up to £250 from any one source in a tax year.
- Welfare counselling.
- Workplace nurseries run by employer at the workplace or at other non-domestic premises (including facilities run jointly with other employers or local authorities).
- Contribution towards home worker expenses up to £6 per week or £26 per month without documentation, more with documentation.
- Job related accommodation.
- Relocation and removal expenses up to £8,000.
- Overnight expenses up to £5 per night in UK and £10 per night overseas.
- Employer liability insurance, death in service benefits and permanent health insurance.
- Medical insurance and treatment while working abroad.
- Security assets and services. Where a security asset or security service is provided by reason of employment, or where reimbursement is made for the cost of such measures.

- Eye care tests and/or corrective glasses for display screen equipment use by employees, provided they are made available to all employees.
- Long service awards up to £50 per year of service to mark employment of 20 years or more.
- Loans with a beneficial interest rate, provided the loan is ≤ £10,000 throughout the year (see later).
- Provision of travel, accommodation and subsistence during public transport disruption caused by industrial action.
- Awards made under a staff suggestion scheme.
- Workplace charging for electric vehicles.

Taxable benefits

Note that a benefit is taxable if

- it arises 'by reason of employment', and
- is provided either to the employee or to a member of the employee's family or household
- either directly by the employer or by a third party.

The following table summarises the key taxable benefits:

General rule = Taxed on:
<ul style="list-style-type: none"> • Cost to the employer • Marginal cost to the employer if an 'in house' benefit
Specific valuation rules for some benefits:
<ul style="list-style-type: none"> • Vouchers • Credit cards • Living accommodation • Expenses relating to living accommodation • Use and gift of assets • Cars, fuel and vans • Beneficial loans • Scholarships • Payment of a director's liability

Remember that:

- Where a benefit is only available for part of the year, the taxable amount is time apportioned.
- Where an employee contributes towards the benefit, the employee contribution is an allowable deduction (exception = the provision of private fuel).
- Where employers provide in-house benefits (such as free air tickets for employees of an airline) the measure of the benefit is the additional or marginal cost incurred by the employer, not a proportion of the total cost.

A reminder of the rules relating to these benefits is given below and the rules are summarised in the diagram in section 5. Revision examples are provided to check your retention of the required TX knowledge.



Vouchers and credit cards

Cash vouchers

A voucher that can be exchanged for an amount of cash that is greater than, equal to, or not substantially less than the cost of providing it. For example, premium bonds. The taxable amount is the amount for which the voucher can be exchanged.

Non-cash vouchers

Employees provided with non-cash vouchers are taxed on the cost to the employer of providing the voucher. Non-cash vouchers are vouchers that can be exchanged for goods or services (e.g. retail vouchers) and includes transport vouchers (e.g. travel season tickets).

Credit cards

Employees provided with credit cards by their employer will be taxed on the value of any costs charged to the card for personal use.



Living accommodation

	Taxable benefit
Basic charge	Higher of <ul style="list-style-type: none"> • Annual value of property • Rent paid by employer, if any (only applicable if property rented on behalf of employee).

Additional charge for expensive accommodation	<ul style="list-style-type: none"> • Only applicable if property purchased by employer (not rented) and the property 'cost' in excess of £75,000 • $\text{Benefit} = (\text{'Cost' of accommodation less } £75,000) \times \text{ORI}\%$ • 'ORI' is the official rate of interest, currently 2.25%. The official rate of interest will be provided in the examination • 'Cost' = purchase price of property plus the cost of capital improvements made before the start of the tax year • If property is owned by the employer for more than six years before providing it to the employee: Use MV of property when first provided (not purchase price) • Irrespective of MV the additional charge will only apply to a property where the original cost plus improvements completed prior to the start of the tax year exceeds £75,000.
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Job related accommodation (JRA)

No benefit arises where the property is job-related accommodation.

- To qualify as JRA, the property must be provided:
 - where it is necessary for the proper performance of the employee's duties (e.g. a caretaker)
 - for the better performance of the employee's duties and, for that type of employment, it is customary for employers to provide living accommodation (e.g. hotel-worker)
 - where there is a special threat to the employee's security and the employee resides in the accommodation as part of special security arrangements (e.g. prime minister).
- A director can only claim one of the first two exemptions if the director:
 - has no material interest in the company (i.e. holds no more than 5% in the company's ordinary share capital), and
 - is a full-time working director or the company is a non-profit making organisation.



Living accommodation expenses

Expenses connected with living accommodation (i.e. ancillary benefits), such as lighting and heating, and use of assets provided in the accommodation are taxable on an employee where the cost is met by the employer as follows:

Benefit	If not JRA	If JRA
Expenses in connection with living accommodation	Cost to employer	Total benefits = limited to 10% rule (see note below)
Use of assets	20% rule (see below)	

Notes

- The 10% JRA limit applies to the following types of expense:
 - heating, lighting and cleaning
 - repairing, maintaining or decorating the premises, and
 - the use of furniture/goods normal for domestic occupation.
- The total accommodation benefits taxed on an employee for JRA is limited to 10% of 'net earnings'
 - 'net earnings' = employment income (including all taxable benefits other than the living accommodation ancillary benefits).



Use of assets

Where the ownership of the asset is retained by employer, but the employee has private use of the asset, the taxable benefit is:

- 20% × open market value when first made available (usually cost).
- Where the employer rents the asset made available to the employee instead of buying it, the employee is taxed on the higher of:
 - the rent paid by employer
 - 20% rule.
- The provision of one mobile phone to an employee is an exempt benefit. However, the 20% rule will apply to any additional mobile phones provided.



Illustration 1 – Living accommodation

Kauri, a director of Pineapple Ltd, lives in a furnished company flat that cost the company £111,000 on 1 June 2019. He occupied the property from 15 June 2019. The accommodation is not job related.

The annual value of the flat is £2,500 and Kauri pays Pineapple Ltd rent of £150 a month. Furniture was worth £6,000 in June 2019. The company pays £2,000 for the running costs of the flat and £1,500 in council tax.

Calculate Kauri's total taxable benefits for the tax year 2023/24.

Solution

Total taxable benefits – 2023/24

	£
Basic charge (annual value)	2,500
Additional charge $(£111,000 - £75,000) \times 2.25\%$	810
	<hr/>
	3,310
Less: Contribution $(£150 \times 12)$	(1,800)
	<hr/>
Accommodation benefit	1,510
Use of furniture $(20\% \times £6,000)$	1,200
Living expenses benefit	2,000
Council tax	1,500
	<hr/>
Total taxable benefits	6,210
	<hr/>



Gift of assets

- If an employer purchases a new asset and gives it to an employee immediately, the employee is taxed on the cost to the employer.
- Where an employee has had the private use of an asset which is then given to him/her/them, the employee is taxed on the higher of:

	£	£
(i) MV of asset when gifted		X
(ii) MV of asset when first made available to the employee	X	
Less: Benefits already taxed on employee for private use	(X)	
	<hr/>	X

- Any employee contribution is deducted from the taxable amounts computed according to the rules above.
- Where the asset being given to an employee is a used car or van or bicycle provided for work:
Benefit = method (i) above (i.e. ignore method (ii)).



Illustration 2 – Use and gift of asset

Rooney was provided with a new video camera by his employer on 6 October 2021 costing £2,000. He was allowed to keep the camera on 5 January 2024 when its value was £500.

Show the benefit taxable on Rooney for all years.

Solution

Taxable benefits

		£
2021/22	Use of asset: $(£2,000 \times 20\% \times 6/12)$	200
2022/23	Use of asset: $(£2,000 \times 20\%)$	400
2023/24	Use of asset: $(£2,000 \times 20\% \times 9/12)$	300
	Plus	
	Gift of asset: (working)	1,100
	Total amount taxable in the tax year 2023/24	1,400

Working: Gift of asset

	£	£
2023/24	Further benefit on gift of asset – higher of	
(i)	MV at date of gift	500
(ii)	MV when first made available	2,000
	Less: Taxed to date	
	$(£200 + £400 + £300)$	(900)
		1,100



Cars

- Where a car is made available for private use, the taxable benefit is:

	£
Appropriate % × List price of car when first registered	X
Less: Employee contributions for private use of car	(X)
	<hr/>
Taxable benefit	X
	<hr/>

- The list price of the car is the price when first registered
 - includes the cost of extras, both those provided with the car and any made available subsequently
 - can be reduced by any capital contribution made by the employee, subject to a maximum of £5,000.
- The appropriate percentage:
 - depends on the rate at which the car emits carbon dioxide and, if electric, its driving range.
- Company diesel cars which meet the real driving emissions (RDE2) standard are treated as if they are petrol cars.
- The rules can be summarised as follows:

A 2% percentage applies to electric cars with zero CO₂ emissions.

For hybrid-electric cars with CO₂ emissions between 1 and 50g/km:

Electric range	%
130 miles or more	2
70 to 129 miles	5
40 to 69 miles	8
30 to 39 miles	12
Less than 30 miles	14

For petrol cars (and diesel cars meeting the RDE2 standard):

CO ₂ emissions per km	%
51 to 54 grams	15
55 grams	16
Over 55 grams	An additional 1% is added for every complete 5 grams above 55 grams.

- To calculate the additional percentage:
 - Round the CO₂ emissions down to the nearest 5g/km
 - Add a 4% supplement for diesel cars (other than those meeting the RDE2 standard)
 - The maximum % that can be applied to any car is 37%.
- The benefit
 - is reduced by periods for which the car was unavailable for more than 30 consecutive days.
 - is reduced if the employee makes contributions towards the running costs.
 - takes into account all running expenses of the vehicle.

Therefore, there is no additional charge for insurance, repairs, car tax, etc.
- A separate benefit applies if private fuel is provided.
- If more than one car is provided to employee/relative, then separate benefits for the car and private fuel are calculated for each car.
- No benefit on pool cars.



Private fuel

- Where an employer provides private fuel the benefit is:
(same percentage used for car benefit × £27,800).
- The £27,800 is given in the tax rates and allowances in the examination.
- Contributions made by the employee towards the private fuel are ignored unless all private fuel is reimbursed in full (in which case no benefit arises).
- The benefit charge is reduced for periods of non-availability, unless non-availability during the tax year is only temporary.



Test your understanding 3

Charles took up employment with Weavers Ltd on 1 July 2023.

His remuneration package included a new petrol driven car, list price £24,000. He took delivery of the car on 1 July 2023. The CO₂ emission rating is 204g/km.

As a condition of the car being made available to him for private motoring, Charles paid £100 per month for the car and £50 per month for petrol during 2023/24.

Weavers Ltd incurred the following expenses in respect of Charles' car:

	£
Servicing	450
Insurance	780
Fuel (of which £1,150 was for business purposes)	2,500
Maintenance	240

Calculate Charles' taxable car and fuel benefits for the tax year 2023/24.



Van benefit

Where a van is made available for private use to an employee the taxable benefit is:

- £3,960 p.a. for unrestricted private use of the van.
- £757 p.a. if private fuel is provided by the employer.
- These benefits are time apportioned if the van is unavailable to the employee for 30 consecutive days or more during any part of the tax year.
- Taking the van home at night is not treated as private use and incidental private use is also ignored if insignificant.
- Contributions by the employee towards the van (not the fuel) reduce the benefit chargeable.
- Where employees share the private use of the van, the scale charge is divided between the employees, on a just and reasonable basis (e.g. by reference to the amount of private use).
- There is no van benefit or van fuel benefit for vans with zero CO₂ emissions.



Illustration 3 – Company car vs. van

Ankle plc is offering Nisanur, a higher rate taxpayer, two possible new vehicles for her private use. The first vehicle on offer is a new petrol engined car with a list price of £15,000 including VAT and CO₂ emissions of 84g/km.

The second vehicle is a petrol engined van with the same list price and CO₂ emissions. Private use of the van is not considered to be insignificant.

Ankle plc will pay for all running costs including fuel for both vehicles.

Calculate the benefit taxable on Nisanur in the tax year 2023/24 for the two vehicles and advise her which one she should select.

Solution

Option 1 – Provision of company car

	£
Car benefit (£15,000 × 21%) (W)	3,150
Fuel benefit (£27,800 × 21%)	5,838
	<hr/>
Total benefits	8,988
	<hr/>

Option 2 – Provision of company van

	£
Van benefit	3,960
Fuel benefit	757
	<hr/>
Total benefits	4,717
	<hr/>

Conclusion: The company van would be more tax efficient.

Working: Appropriate percentage for company car

$$16\% + ((80 - 55) \times 1/5) = 21\%$$



Beneficial loan

- Beneficial loans are loans made to an employee with an interest rate below the official rate of interest (2.25% for the tax year 2023/24).
- The benefit is calculated as follows:

	£
Interest at the official rate	
(using either the average or precise method)	X
Less: Interest actually paid in the tax year	(X)
	—
Taxable benefit	X
	—
- A small loan exemption applies where the total of an employee's beneficial loans is \leq £10,000 throughout the tax year.
- Two methods of calculating the interest at the official rate:
 - Average method = charge is based on the average capital
 $\text{average capital} = (\text{opening balance} + \text{closing balance}) \times 1/2$
 - Precise method = calculate interest on a day to day basis
 (calculations should be done to the nearest month in the exam) on the balance of the loan outstanding.
- Either the taxpayer or HMRC can elect for the precise method.
- HMRC will only elect where it appears that the average method is being exploited and the precise method gives a materially higher figure.



Illustration 4 – Beneficial loan

Daniel was granted a loan of £35,000 by his employer on 31 March 2023 to help finance the purchase of a yacht. Interest is payable on the loan at 1% per annum.

On 1 June 2023 Daniel repaid £5,000 and on 1 December 2023 he repaid a further £14,000. The remaining £16,000 was still outstanding on 5 April 2024.

Calculate the taxable benefit for the tax year 2023/24 using both the average method and the precise method.

Solution

Average method	£	£
$(£35,000 + £16,000) \times 1/2 \times 2.25\%$		574
Less: Interest paid		
6.4.2023 – 31.5.2023 $£35,000 \times 1\% \times 2/12$	58	
1.6.2023 – 30.11.2023 $£30,000 \times 1\% \times 6/12$	150	
1.12.2023 – 5.4.2024 $£16,000 \times 1\% \times 4/12$	53	
	—	(261)
Taxable benefit		313

Precise method

	£
6.4.2023 – 31.5.2023 $£35,000 \times 2.25\% \times 2/12$	131
1.6.2023 – 30.11.2023 $£30,000 \times 2.25\% \times 6/12$	338
1.12.2023 – 5.4.2024 $£16,000 \times 2.25\% \times 4/12$	120
	589
Less: Interest paid – as above	(261)
Taxable benefit	328

The taxable benefit will be the average method of £313 unless an election is made.

Daniel will not make the election for the precise method.

It is unlikely that HMRC will elect for the precise method in this example.



Scholarships

If a scholarship is provided to a member of an individual's family or household, the cost of it is taxable as a benefit on the individual.

No taxable benefit arises where:

- the scholarship is awarded from a separate trust scheme, and
- the person receiving it is in full-time education at a school, college or university, and
- not more than 25% of payments made in the tax year from the scheme are made by reason of a person's employment.

Scholarship income is exempt in the hands of the recipient.



Payment of director's tax liability

- Where tax should have been deducted from a director's earnings under the PAYE system, but was not, and the tax is paid over to HMRC by the employer, the director is treated as receiving a benefit.
- The benefit is the amount of tax accounted for, less any amount reimbursed by the director (if any).
- Note that this rule applies only to directors.

Comprehensive example



Test your understanding 4

Vigorous plc runs a health club. The company has three employees who received benefits during the tax year 2023/24 and it therefore needs to prepare forms P11D for them. The following information is relevant:

Andrea

- (1) Andrea was employed by Vigorous plc throughout the tax year 2023/24.
- (2) Throughout the tax year 2023/24 Vigorous plc provided Andrea with a new hybrid-electric company car with a list price of £19,400. The official CO₂ emission rate for the car is 35g/km and the electric range is 25 miles. Vigorous plc paid for all of the car's running costs of £3,200 during the tax year 2023/24, including petrol used for private journeys. Andrea pays £150 per month to Vigorous plc for the use of the car.

- (3) Vigorous plc has provided Andrea with living accommodation since 1 November 2021. The property was purchased on 1 January 2019 for £143,800. The company spent £14,000 improving the property during March 2020, and a further £8,000 was spent on improvements during May 2023. The value of the property on 1 November 2021 was £170,000, and it has an annual rateable value of £7,000. The furniture in the property cost £6,000 during November 2021. Andrea personally pays for the annual running costs of the property amounting to £4,000.
- (4) Throughout the tax year 2023/24 Vigorous plc provided Andrea with a mobile telephone costing £500. The company paid for all business and private telephone calls.

Ben

- (1) Ben commenced employment with Vigorous plc on 1 July 2023.
- (2) On 1 July 2023 Vigorous plc provided Ben with an interest-free loan of £120,000 so that he could purchase a new main residence. He repaid £20,000 of the loan on 1 October 2023.
- (3) During the tax year 2023/24 Vigorous plc paid £9,300 towards the cost of Ben's relocation. His previous main residence was 125 miles from his place of employment. The £9,300 covered the cost of disposing of Ben's old property and of acquiring his new property.
- (4) During the period from 1 October 2023 until 5 April 2024 Vigorous plc provided Ben with a new diesel-powered company car which has a list price of £11,200. The official CO₂ emission rate for the car is 94g/km and the car does not meet the RDE2 standard. Ben reimburses Vigorous plc for all the diesel used for private journeys.

Chai

- (1) Chai was employed by Vigorous plc throughout the tax year 2023/24.
- (2) During the tax year 2023/24 Vigorous plc provided Chai with a two-year old company van, which was available for private use. The van has CO₂ emissions of 113g/km and the private use was not considered to be insignificant. The van was unavailable during the period 1 August to 30 September 2023. Chai was also provided with private fuel for the van.
- (3) Vigorous plc has provided Chai with a television for her personal use since 6 April 2021. The television cost Vigorous plc £800 in April 2021. On 6 April 2023 the company sold the television to Chai for £150, although its market value on that date was £250.

- (4) Throughout the tax year 2023/24 Vigorous plc provided Chai with free membership of its health club. The normal annual cost of membership is £800. This figure is made up of direct costs of £150, fixed overhead costs of £400 and profit of £250. The budgeted membership for the year has been exceeded, but the health club has surplus capacity.
- (5) On 1 January 2024 Vigorous plc provided Chai with a new computer costing £1,900. She uses the computer at home for personal study purposes.

Calculate the benefit figures that Vigorous plc will have to include on the forms P11D for Andrea, Ben and Chai for the tax year 2023/24.

Tax efficient remuneration

A possible scenario in the exam could be to test income tax planning through the comparison of different remuneration packages.

A selection of areas to consider are:

- the provision of a company car compared to using the individual's own car and claiming mileage allowance
- comparison of tax advantaged and non-tax advantaged share schemes (see later)
- using a range of exempt benefits.



Test your understanding 5

Workout plc runs a nation-wide chain of health clubs, with each club being run by a manager who is paid an annual salary of £60,000. The company has a flexible remuneration policy in that it allows managers to enhance their salary by choosing from a package of benefits.

Ibrahim is to be appointed as a manager of Workout plc on 6 April 2023 and he has asked for your advice regarding the tax implications arising from each aspect of the benefits package.

The package is as follows:

Car

Option 1:

Workout plc will provide a new petrol car with a list price of £19,200 and CO₂ emissions of 102g/km, and will pay for all running costs, including private fuel. Ibrahim will make a capital contribution of £3,000 towards the cost of the car, and will also be required to contribute a further £50 per month towards its private use. He will drive a total of 1,750 miles per month, of which 60% will be in respect of journeys in the performance of his duties for Workout plc.

Option 2:

Alternatively, Workout plc will pay Ibrahim additional salary of £500 per month, and he will lease a private car. Workout plc will then pay an allowance of 30 pence per mile for business mileage.

Accommodation

Option 1:

Ibrahim currently lives 140 miles from where he is to be employed by Workout plc. The company will pay £7,500 towards the cost of relocation, and will also provide an interest free loan of £90,000 in order for Ibrahim to purchase a property. The loan will be repaid in monthly instalments of £1,000 commencing on 15 April 2023.

Option 2:

Alternatively, Workout plc will provide living accommodation for Ibrahim. This will be in a house that the company purchased in 2006 for £86,500. The house has a rateable value of £7,700 and is currently valued at £135,000. The furniture in the house cost £12,400. Workout plc will pay for the annual running costs of £3,900.

Telephone

Option 1:

Workout plc will provide Ibrahim with a mobile telephone costing £500, and will pay for all business and private telephone calls.

Option 2:

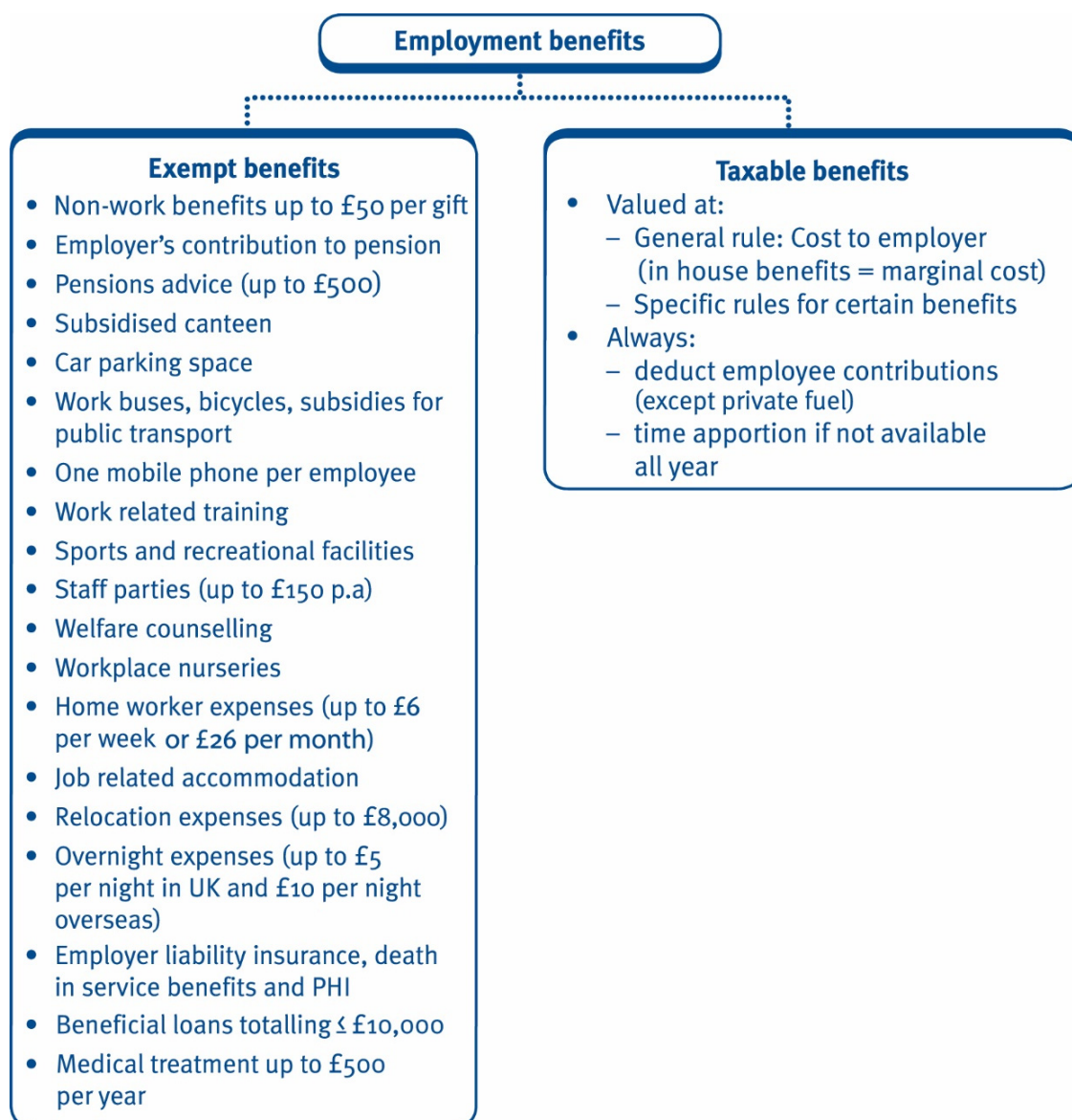
Alternatively, Workout plc will pay Ibrahim £75 per month towards the cost of his fixed telephone at home. The total annual cost will be £1,400, of which £300 is for line rental, £650 for business telephone calls and £450 for private telephone calls.

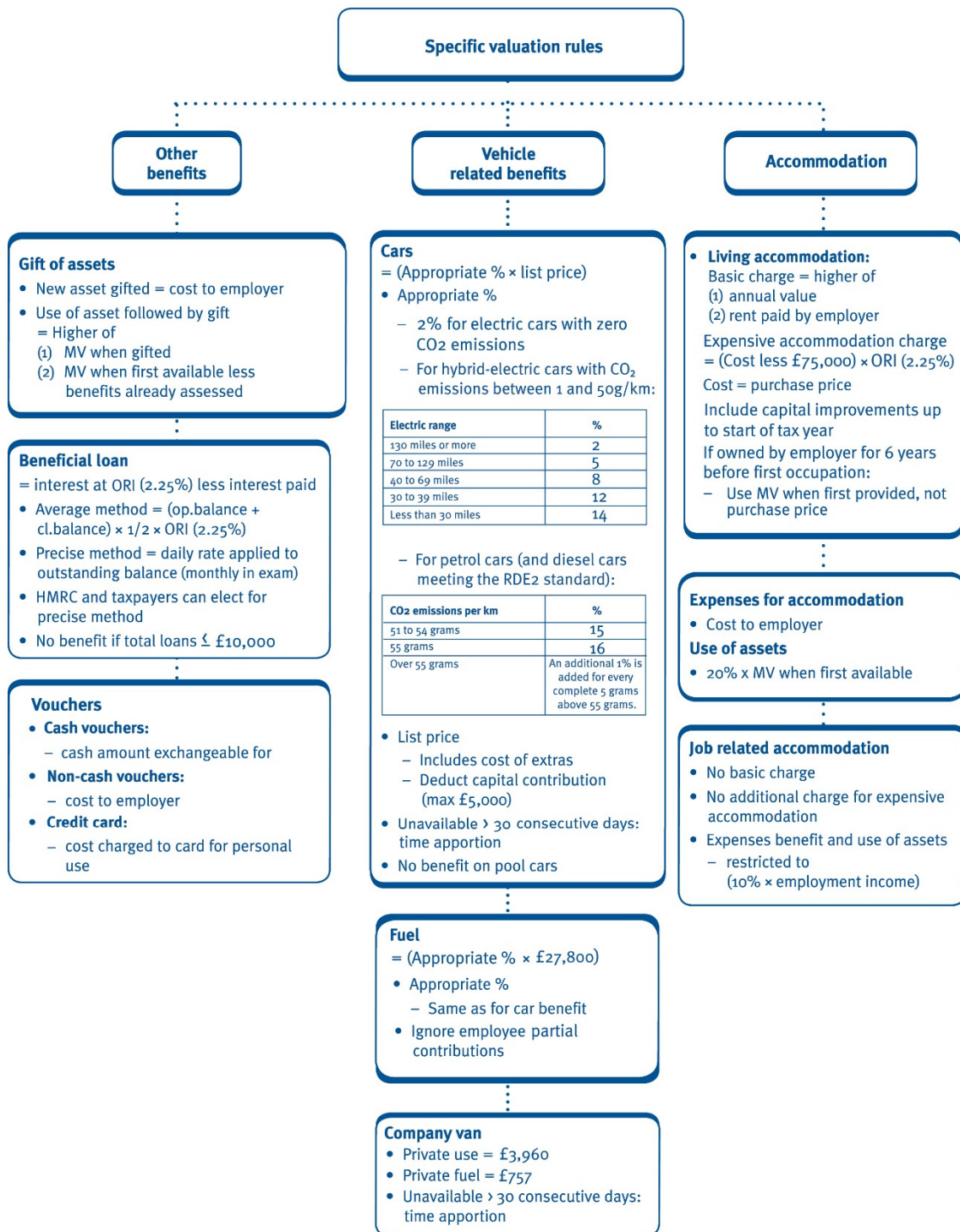
Explain the tax implications for Ibrahim arising from each aspect of the benefits package.

You should assume that benefits are provided on 6 April 2023.

VAT and the tax implications for Workout plc should be ignored.

5 Summary





6 Share schemes

It has long been recognised by employers that there are commercial benefits in schemes to motivate employees that are linked to a company's profitability.

These may take the form of:

- Share incentives – the allocation of company shares to the employee.
- Share options – the grant of options to buy company shares in the future.

Successive governments have encouraged these incentives by giving tax privileges to schemes, provided that they meet the relevant requirements.

Schemes that satisfy conditions have significant tax advantages and those that do not are not tax advantaged.

Formal HMRC approval used to be required to establish a tax advantaged scheme, however such approval is no longer needed. Nevertheless, the two types of scheme are often still referred to as 'approved' schemes and 'unapproved' schemes.

Share options

A share option is an offer to an employee of a right to purchase shares at a future date at a predetermined fixed price set at the time the offer is made.

The taxation consequences of share options for an employee depends on whether or not the share options are tax advantaged, as follows:

Event	Non-tax advantaged (unapproved)	Tax advantaged (approved)
Granting of option.	No tax	No tax
Exercise of option.	Income tax charge: <div style="text-align: right;">£</div> MV @ exercise date X Cost of option (X) Cost of shares (X) <div style="text-align: right;">—</div> Employment income X <div style="text-align: right;">—</div> NIC charge if shares readily convertible into cash. (Note 1)	No tax (Note 2)

Disposal of shares.	Capital gain arises:		Capital gain arises:	
		£		£
	Sale proceeds	X	Sale proceeds	X
	MV @ exercise date	(X)	Cost of option	(X)
			Cost of shares	(X)
		—		—
	Gain (Note 3)	X	Gain (Note 3 + 4)	X
		—		—

Notes:

- (1) Class 1 will apply where the shares are quoted, which will be payable by the employee and employer.
- (2) For tax advantaged enterprise management incentive (EMI) schemes there may be an income tax charge on exercise, if the options are issued at a discount to the MV at grant.
- (3) Business asset disposal relief (BADR) will be available if:
 - the company is a trading company
 - the employee owns $\geq 5\%$ interest in the ordinary share capital of the company, and
 - the employee has owned the shares for at least two years.
- (4) For EMI schemes, for BADR:
 - there is no requirement to hold $\geq 5\%$ shareholding, and
 - the two-year ownership period can be counted from the date the option was granted (not when the shares acquired).



Test your understanding 6

Alan is employed by Sugar Ltd, a trading company. On 1 July 2019 he was granted the option to buy 1,000 shares in Sugar Ltd for £2, their market value at that time.

He exercises the option on 17 October 2023 when the shares are worth £4.50. On 20 October 2023 he sells them for £5 each.

The shareholding represents less than a 5% interest in the company.

Explain the tax implications for Alan of the above events assuming the scheme is tax advantaged or non-tax advantaged.

Share incentives

An employer may gift shares in the employing company to an employee or allow the employee to buy them at a discounted price.

Where this happens the employee will include in taxable earnings:

Value of the shares less price paid (if any) for the shares

In the ATX exam, if the shares are quoted they are 'readily convertible' and so this amount will also be liable to class 1 NIC.

Where shares are unquoted, and not 'readily convertible' no NIC will apply.



7 Tax advantaged share option and incentive schemes

There are four types of scheme that receive favourable tax treatment:

- Savings-related share option schemes (SAYE)
- Company share option plans (CSOP)
- Enterprise management incentive scheme (EMI)
- Share incentive plans (SIP).

The detail of how each scheme operates and the conditions which must be satisfied is given later in this section.

The conditions and key rules are summarised in the tables below.

	CSOP	EMI	SAYE
Participation	Employer chooses	Employer chooses	All employees
Maximum value	£30,000 per employee	£250,000 per employee Scheme max £3m	£500 per month
Exercise period	3 – 10 years	Up to 10 years	3 or 5 years
Issue price	MV	Issue at MV to avoid IT charge on exercise	Not < 80% of MV
Base cost of Shares for CGT	Price paid	Price paid plus discount (if any) taxed as income on exercise	Price paid
Other	If own > 30% of company = excluded from scheme	Gross assets < £30m Employees < 250 BADR period of ownership runs from date of grant, and no need to own ≥ 5% of OSC	

Share incentive plan (SIP)	
Participation	All employees
Awarded free shares	Max £3,600 per year
Purchase partnership shares (cost = allowable deduction against employment income)	Max = lower of: <ul style="list-style-type: none"> • £1,800, and • 10% salary
Awarded matching shares	Max two per partnership share
Dividends	Tax free if invested in further shares
Holding period	Five years for full benefit
Base cost of shares	MV when removed from plan



SAYE option scheme

There is favourable tax treatment for share option schemes that are linked to a SAYE (Save As You Earn) contract.

How the scheme operates

- The employees pay a maximum of £500 per month into a SAYE scheme, for a period of three or five years.
- Interest on the scheme is exempt from income tax.
- At the end of the scheme the money can be used to exercise the share options or the employee may just withdraw the money for personal use.

As a tax advantaged scheme

- No income tax will be charged on the grant or exercise of the option.
- On the subsequent disposal of the shares, a capital gain may arise.

Conditions for the SAYE scheme

All employees must be able to participate in the scheme on similar terms although it is acceptable to exclude employees who have worked for the company for less than a qualifying period, as long as the period chosen does not exceed five years.

- The purchase price of the shares is usually met by the employee out of the SAYE accumulated savings.
- The price at which options are offered is not less than 80% of market value of the shares when the option was granted.
- The costs of setting up such a scheme are allowable as a trading expense for the company.



Company share option plan (CSOP)

- This type of tax advantaged share option scheme differs from the SAYE schemes described above in that:
 - the aggregate value of options granted is potentially much higher
 - the company has much greater discretion in allocating options to employees.

How the scheme operates

- The company grants the employee the right to buy shares at some time in the future, at a price fixed at the time of the grant of the option.
- Sometime later the employee will pay the required amount and the shares are issued to the employee.
- As a tax advantaged scheme:
 - There is no income tax or NIC charge on the grant of the option.
 - On the exercise of an option there is no charge to tax.
 - On the final disposal of scheme shares, CGT will be charged on any gain arising.

Conditions for the CSOP scheme

- Eligible employees must be either full-time directors (i.e. working at least 25 hours per week) or full-time or part-time employees.
- Close company directors with a material interest (> 30%) are ineligible. Subject to the above, the company has complete discretion as to participants.
- The option must be exercised between three and ten years of the grant.
- The price payable for the shares should not be less than the market value at the time of the grant.
- There is a £30,000 limit to the value of shares for which a participant may hold unexercised options at the time.
- Employees owning more than 30% of the company are ineligible to participate.
- The costs of setting up such a scheme are allowable as trading expenses.
- Participation in the scheme need not be extended to all employees nor be on equal terms to all participants.



Enterprise management incentive scheme (EMI)

The EMI scheme was introduced to enable options to be granted to selected employees in smaller companies. The rules are more generous than for CSOPs.

How the scheme operates

- Enterprise management incentive schemes enable options worth up to £250,000 to be granted to **selected** employees.
- As a tax advantaged scheme:
 - There is no income tax or NIC charge on the grant of the option.
 - No income tax or NIC is charged on the exercise of the option if the option price at the time of grant was at least MV at that time.
 - If the exercise price was granted at a discount, the charge is based on the difference between the market value at the date of the grant and the exercise price (if any).
 - The CGT base cost of the shares is the price paid plus the discount (if any) that has been treated as income on exercise.
 - On sale of the shares, the period for which the option is held can be counted as part of the two year ownership period for business asset disposal relief.

Conditions for the EMI scheme

- There is no limit on the number of employees who may benefit, although the total value of options granted by the company may not exceed £3 million.
- Qualifying companies must have < 250 full-time employees.
- An employee must work for the company for at least 25 hours per week, or for at least 75% of the employee's working time if less, and must not have a material interest in the company (i.e. > 30%).
- The company must be a qualifying trading company. Certain trades, such as property development, are excluded. The company's gross assets must not exceed £30 million.
- An employee may not be granted options over shares worth more than £250,000 at the time of grant. Options granted under a company share option plan must also be taken into account.
- Options must be capable of being exercised within ten years of grant, and may be granted at a discount, or at a premium.
- The company must not be a 51% subsidiary or otherwise controlled by another company and persons connected with that company.



Share incentive plans (SIPs)

A SIP is a scheme that allows employers to give shares to their employees, and for the employees to buy further shares, without an income tax charge.

On disposal CGT will apply to any profit made.

How the scheme operates

A SIP can involve the employees acquiring shares in three different ways.

- The employer may gift up to £3,600 shares to the employee each year. The amount received is usually dependent on the financial performance of the company. These are referred to as free shares.
- Depending on the terms of the specific scheme an employee **may** be allowed to buy up to £1,800 of partnership shares. The cost is deducted from the employee's pre-tax salary (up to a maximum of 10% of salary).
- Depending on the terms of the specific scheme the employer **may** choose to issue further free shares on a 2:1 basis to the partnership shares, so if the employee buys £1,800 the employer may issue a further £3,600 of shares at no cost to the employee. These are referred to as matching shares.
- Not all schemes offer partnership or matching shares.
- Dividends paid on an employee's shares held under the plan can be reinvested tax free in further shares. There is no limit to the amount of dividends that can be reinvested in the SIP.
- As a tax advantaged scheme:
 - There is no income tax or NIC charge on the acquisition of the shares.
 - On the final disposal of scheme shares, CGT will be charged on any gain arising.

Conditions for the SIP

The plan must be available to all employees of the company or a group company. However, employees with less than 18 months of service can be excluded.

- The plan must have no arrangements for loans to employees.
- For the tax-free advantages, the plan shares must be held for at least five years.

Taxation consequences of the value received

The taxation consequences of the value received from tax advantaged SIP are as follows:

Income tax and NICs

- Shares held in the plan for five years
If free, partnership or matching shares are held in a plan for five years, there is no income tax or NIC charge at the time the plan shares are awarded.
Dividend income used to acquire shares is tax-free as long as the shares are held in the plan for three years.
- Shares held in the plan for three to five years
If the shares have been held for between three and five years, income tax and NIC will be charged on the lower of:
 - (i) the initial value of the shares, or
 - (ii) the value at the date of withdrawal.
- Shares held in the plan for less than three years
Income tax and NIC will be payable on their value at the time when they cease to be held in the plan.

Capital gains

- If employees take the shares out of the plan and sell them later, there is a capital gain arising on the increase in value after the shares were withdrawn.
- To calculate the gain, the cost of the shares is their value when taken out of the plan.
Accordingly, if the shares are sold on the same day they are taken out of the plan, no gain arises.

Choice of tax advantaged scheme

In order to decide which scheme is most appropriate, the conditions of each scheme should be compared to the employer's requirements.

Key factors to consider are:

- Does the employer want to reward all employees, or just key employees?
- What size is the employer's business?
EMI is only available to smaller companies.
- Does the employer want to award shares or offer share options?
- How much does the employer want to offer?
- What holding period for the shares/options does the employer want to impose?



Illustration 5 – Tax advantaged vs. non-tax advantaged schemes

Claire is granted share options in her employing company, a fully listed plc. Claire has an annual salary of £60,000.

The planned arrangements are as follows:

- (1) The cost of the option is 5p per share.
- (2) 10,000 shares can be acquired for £1.60 per share (= market value at grant of option).
- (3) The share option can be exercised at any point after three years but before ten years has expired. Claire will exercise her options in November 2023.
- (4) The MV of shares at the exercise date in November 2023 will be £3.80.
- (5) The shares are sold in January 2024 for £4.20 per share.

Other capital transactions by Claire during the tax year 2023/24 have utilised her annual exempt amount.

Assuming the share option scheme is either non-tax advantaged or a tax advantaged company share option plan:

- (a) Prepare a table of the tax charges for Claire arising on the above events.
- (b) State the overall net cash position of the transaction, including the preferred option.

Solution

(a) Tax charges

	Non-tax advantaged scheme	Tax advantaged CSOP
	£	£
IT (W1)	8,600	0
NICs (W1)	430	0
CGT (W1) (W2)	800	5,100
	<hr/>	<hr/>
Total	9,830	5,100
	<hr/>	<hr/>

(b) **The net cash position:**

	Non-tax advantaged scheme £	Tax advantaged CSOP £
Receipt on disposal	42,000	42,000
Less:		
Costs to acquire shares	(16,500)	(16,500)
Tax charges	(9,830)	(5,100)
Net cash flow	15,670	20,400

Clare will therefore be £4,730 (£20,400 – £15,670) better off if the share options are organised through a CSOP scheme. This is clearly due to the lower tax charge of £4,730 (£9,830 – £5,100).

Note: If the requirement had just asked for the tax saving or the cash benefit of the CSOP scheme, the answer could be calculated more quickly at the margin.

As £21,500 will be taxed at 20% to CGT instead of 42% (40% income tax and 2% NICs), the tax saving will be:

$$£21,500 \times (42\% - 20\%) = £4,730.$$

Workings

(W1) Non-tax advantaged scheme

- No tax charge at grant
- Exercise

	£
MV at date of exercise (10,000 × £3.80)	38,000
Less:	
Cost of option (10,000 × 5p)	(500)
Cost of shares	(16,000)
Employment income	21,500
Income tax charged (£21,500 × 40%) (Note)	8,600
Employee's NICs (£21,500 × 2%) (Note)	430

Note: Claire's employment income already means she is a HR taxpayer and the NIC upper limit is exceeded. Therefore, she will be taxed at 40% on additional employment income and 2% NICs.

- Sale of shares

	£
Sale proceeds (10,000 × £4.20)	42,000
Less: MV at date of exercise	(38,000)
	<hr/>
Chargeable gain = Taxable gain (Note)	4,000
	<hr/>
CGT (£4,000 × 20%) (Note)	800
	<hr/>

Note: Claire has already used all of her AEA, therefore her additional chargeable gain is all taxable. As her taxable income is greater than £37,700, her gain is taxed at 20%.

(W2) Tax advantaged scheme

- No tax charge at grant.
- No tax charge at exercise.
- With a tax advantaged scheme the whole profit is charged to CGT on the ultimate disposal of the shares.

	£
Sale proceeds	42,000
Less:	
Cost of option	(500)
Cost of shares	(16,000)
	<hr/>
Chargeable gain = Taxable gain	25,500
	<hr/>
CGT (£25,500 × 20%)	5,100
	<hr/>



8 Lump sum payments on termination or variation of employment

Lump sum payments from employment may be:

- partially exempt
- wholly exempt, or
- wholly chargeable

The tax treatment of a lump sum payment made to an employee on the cessation of employment depends on whether or not the payment is a genuine redundancy payment on the cessation of employment.

Taxation treatment

The position is summarised in the table below:

Wholly exempt	Partially exempt	Wholly chargeable
<ul style="list-style-type: none"> Statutory redundancy payments (Note) Payments for injury, disability or death Payments made to a pension scheme Lump sum payments from a registered pension scheme 	<ul style="list-style-type: none"> Genuine discretionary (ex gratia) termination payments (see below) <ul style="list-style-type: none"> first £30,000 exempt limit reduced if statutory redundancy payments received 	<ul style="list-style-type: none"> Any payment which is contractual (e.g. restrictive covenants) Any other payment received which is expected, usual employer practice (e.g. gardening leave, customary payments in lieu of notice)

Note: Strictly, statutory redundancy payments are partially exempt and fall under the same category as genuine discretionary termination payments. However, statutory redundancy is paid at such a level that it is currently impossible to receive over £30,000 and so it will always be fully exempt.

Genuine ex gratia termination payments include:

- redundancy payments
- compensation for loss of office
- some non-contractual payments made in lieu of notice (see below)
- damages for breach of contract or wrongful dismissal.

Taxable amounts are:

- Taxed in the year of receipt
- Paid net of PAYE if paid before leaving and P45 issued
- Paid net of 20%/40%/45% income tax if paid after leaving and P45 issued
- Taxed as the top slice of the individual's taxable income (after dividend income) at the individual's highest marginal rate of income tax. This will preserve the preferential dividend tax rates.

For NIC purposes any discretionary payment attracting the £30,000 exemption is fully exempt from employee NICs. Only the excess over the £30,000 exemption is subject to class 1A NICs.

Payments in lieu of notice (PILONs) do not normally qualify for the £30,000 exemption, regardless of whether they are contractual or not. Therefore, most PILONs are subject to both income tax and class 1 NICs.

PILONs that are not contractual or the usual employer practice need to be split into two elements:

- 1 The amount which would normally be received if the employee had worked his, her or their notice period in full (this is subject to income tax and class 1 NICs), and
- 2 Any remaining amount (this is exempt from class 1 NICs and is subject to income tax and class 1A NICs only to the extent that it exceeds the £30,000 exemption)

Benefits provided following termination:

- Note the first £30,000 exempt rule may also apply to any benefits received as part of the termination package (e.g. the company car).
- The value of the benefit is calculated using the employment income rules (e.g. list price × appropriate %).
- The employer will continue to pay class 1A NICs on the value of the benefit.
- Retraining, counselling or outplacements services provided are exempt benefits.



Test your understanding 7

Katya, age 40 years, received an ex gratia lump sum of £80,000 from her employers following her redundancy in December 2023.

She has other remuneration of £35,000, income from furnished accommodation of £2,745 and dividends received of £1,000 for the tax year 2023/24.

Katya also received £5,000 statutory redundancy pay.

Calculate Katya's income tax liability for the tax year 2023/24.

Unapproved retirement benefits

- Where an ex-gratia payment is made to an employee approaching retirement age, HMRC may deem the payment to be made under an unapproved retirement benefit arrangement and thereby taxable in full (i.e. without the £30,000 exemption).
- Retrospective approval can be given for the sum to be fully exempt.

Other lump sum payments

- Lump sums which are paid but are not in connection with a termination will be taxable if they arise due to employment.
- Where an individual is given a one-off payment as encouragement to take up employment (often known as a golden hello, as described in section 2) this will be subject to income tax and class 1 NICs in full, as it is seen as a reward for future services.
- A payment to compensate an employee for a change of employment terms would also be subject to income tax and class 1 NICs in full.

9 National Insurance Contributions (NICs)

The main classes of NIC paid in respect of an employed individual and the persons who are liable to pay are summarised as follows:

Class of contribution	Basis of assessment	Person liable
Class 1 primary	A percentage-based contribution based on employee earnings in excess of £12,570 per year for the tax year 2023/24 (Note).	Employee
Class 1 secondary	A percentage-based contribution based on employee earnings in excess of £9,100 per year for the tax year 2023/24. Employers obtain £5,000 relief to offset against class 1 secondary NICs (see below).	Employer
Class 1A	A percentage-based contribution based on taxable benefits provided to employees.	Employer

The rules for NICs payable in respect of a self-employed individual are covered in Chapter 21.



A reminder of the rules for class 1 and class 1A contributions covered at TX is given below and is summarised in the diagram at the end of this section.



Class 1 NICs

Class 1 contributions – employed persons

A liability for class 1 contributions arises where an individual:

- is employed in the UK, and
- is aged 16 or over, and
- has earnings in excess of the earnings threshold.

Employee (primary) contributions

- Employee class 1 NICs are paid at 12% and 2%.
- Contributions are calculated as a percentage of **gross earnings** with **no allowable deductions**.
- There is no liability where gross earnings do not exceed the earnings threshold of £12,570 p.a.
- Employee class 1 contributions, at the rate of 12%, are paid on earnings in excess of the threshold but below the upper earnings limit (UEL) of £50,270.
- Earnings in excess of the UEL are subject to a rate of 2%.
- Class 1 NICs are calculated on an 'earnings period' basis (i.e. if paid weekly, 1/52 of the limits are used, and if paid monthly, 1/12 of the limits are used).
- However, in the examination, the annual limits are supplied and it is acceptable to calculate the liabilities on an annual basis.
- Employee class 1 contributions cease when the employee reaches state pension age. In 2018 the state pension age was 65 for both men and women, and this is gradually increasing.
- The employer is responsible for calculating and accounting for the employee class 1 contributions to HMRC under the PAYE system.
- The gross earnings on which class 1 contributions are calculated comprise any remuneration derived from employment paid in cash or assets which are readily convertible into cash.
- Gross earnings includes:
 - Wages, salary, overtime pay, commission or bonus.
 - Sick pay, including statutory sick pay.
 - Tips and gratuities paid or allocated by the employer.
 - Payment of the cost of travel between home and work, or on any profit element where business travel is reimbursed.

For example, where the payment of a mileage allowance is in excess of the HMRC approved rate of 45p per mile, the excess above 45p per mile is subject to class 1 NICs.

- Remuneration, such as bonuses, made by using financial instruments such as shares, unit trusts, options, gilts, gold, precious stones, fine wines and 'readily convertible' assets. An asset is 'readily convertible' if arrangements exist for its purchase.
- Remuneration in the form of cash or non-cash vouchers (e.g. M&S vouchers).
- The following are disregarded in calculating gross earnings for primary contributions:
 - Most benefits (see above regarding use of financial instruments and vouchers).
 - Redundancy payments.
 - Payments of any pension.

Employer's (secondary) contributions

- The rate of employer class 1 NICs is 13.8% on gross earnings above £9,100 p.a.
- The contributions are a deductible expense for the employer when calculating taxable profits.
- There is no liability where gross earnings do not exceed the earnings threshold of £9,100.
- Where earnings exceed the threshold then contributions are paid on earnings in excess of the threshold. There is no reduced rate when earnings exceed the UEL.
- Employer class 1 contributions cease when the employee leaves the employment. There is no upper age limit, the employer is liable in full even if the employee is above state pension age.
- The exemption from employer class 1 NICs for employees aged under 21 and apprentices aged under 25 is not examinable.

NIC employment allowance

Employers are able to claim up to £5,000 relief p.a. from their employer's class 1 NIC contributions.

Note that the allowance:

- cannot be used against any other classes of NICs (e.g. class 1A)
- is claimed through the real time information (RTI) PAYE system
- will be provided in the tax rates and allowances in the exam.

The employment allowance is only available to employers whose employer's class 1 NIC liability was below £100,000 in the previous tax year.

The allowance is not available to companies where a director is the only employee earning over £9,100.



Class 1A contributions

- Employers are required to pay class 1A contributions on taxable benefits provided to P11D employees.
- There is no class 1A charge in respect of any benefits that are already treated as earnings for class 1 contribution purposes (e.g. cash vouchers).
- The rate of class 1A NICs is 13.8%.
- The contributions are a deductible expense for the employer when calculating taxable profits.



Employees reaching state pension age

- An employee who continues to work after attaining state pension age has no liability for employee class 1 NIC contributions.
- The employer is still liable for full employer's class 1 NIC contributions.



Deduction and payment by the employer

- The employer calculates the employee and employer's class 1 contributions at each weekly or monthly pay date.
- At the end of each PAYE month (5th) the total contributions become payable along with income tax deducted under PAYE, not later than 14 days thereafter (i.e. by 19th each month). However, most businesses now pay electronically and are allowed an extra three days. Therefore, the usual payday is **22nd of each month**.
- The class 1A contributions are payable annually in arrears to HMRC by **22nd July** following the end of the tax year.



Persons with more than one job

- A person with more than one job is separately liable for employee class 1 NIC contributions in respect of each job falling within the scope of class 1 contributions (where earnings are over the earnings threshold of £12,570 p.a.).
- Each employer is also separately liable for employer's class 1 NIC contributions.
- The total employee class 1 contributions from all employments is subject to an overall annual maximum.
- Employees with more than one job can prevent overpayment of contributions by applying for deferment of contributions, or claiming a refund after the end of the tax year.



Company directors

- Company directors are deemed to have an annual earnings' period.
- The annual earnings thresholds and the UEL therefore apply.
- The rules prevent directors avoiding NICs by paying themselves a low monthly salary, and then taking a large bonus.

Summary

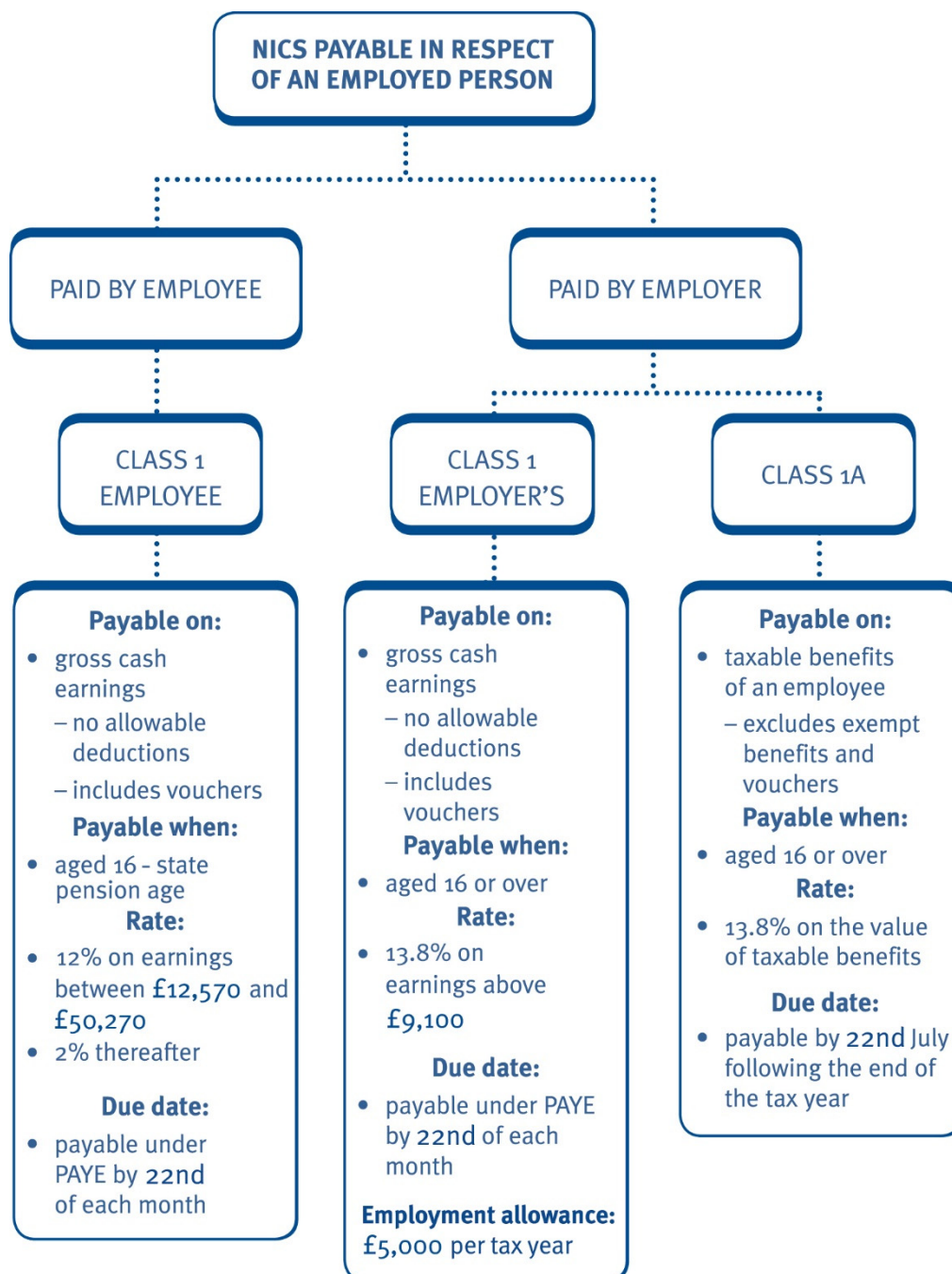




Illustration 6 – NICs

Janet is paid a salary of £18,000 p.a. She was also paid a bonus of £10,000 in the first week of March 2024.

Calculate Janet's class 1 employee NICs for the tax year 2023/24 if she is an employee or a director.

Solution

(i) An employee

If Janet is an employee she will pay NICs on earnings of £1,500 per month ($£18,000 \div 12$) for 11 months and earnings of £11,500 for the month in which the bonus was paid as follows:

	£
$(£1,500 - £1,048 \text{ (Note)}) \times 12\% \times 11 \text{ months}$	597
$(£4,189 - £1,048) \times 12\% \times 1 \text{ month}$	377
$(£11,500 - £4,189 \text{ (Note)}) \times 2\% \times 1 \text{ month}$	146
	<hr/>
	1,120
	<hr/>

Note: Monthly limits

Primary threshold = $(£12,570 \div 12) = £1,048$

Upper threshold = $(£50,270 \div 12) = £4,189$

(ii) A director

If Janet is a director, she will pay NICs by reference to her total earnings in the year as follows.

Annual remuneration = $(£18,000 + £10,000) = £28,000$

Class 1 employee NICs = $(£28,000 - £12,570) \times 12\%$ £1,852



Test your understanding 8

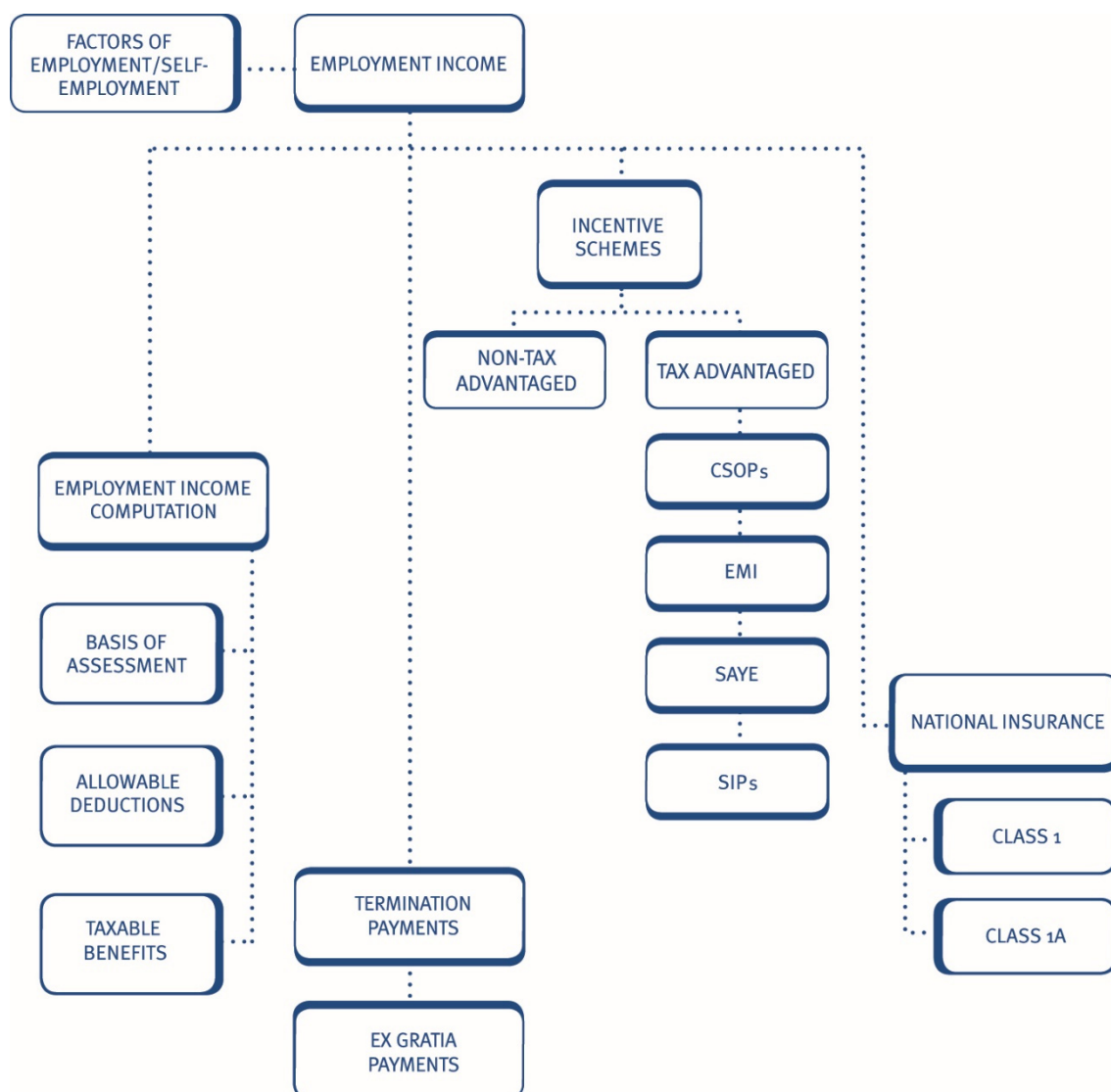
Alex and Sakura are both employed by Abdullo who runs a shoe shop as a sole trader. Alex and Sakura are the only employees of the business. Alex is paid £14,700 and Sakura £57,800 in the tax year 2023/24.

Sakura also receives £9,600 taxable benefits of employment.

Abdullo's employer's class 1 NIC liability for the tax year 2022/23 was £7,000.

Calculate the employee NICs and the total employer's class 1 and class 1A NICs payable for the year.

10 Chapter summary



Test your understanding answers



Test your understanding 1

Yasmeen

As a director of the company, Yasmeen is regarded as receiving the bonus on the earliest of the following dates:

1 September 2023	Actual payment
15 July 2023	Credited in the accounts
30 June 2023	Bonus determined (= after year end date of 31 March 2023)

Accordingly, the bonus is taxable on 30 June 2023.



Test your understanding 2

Lotte**(a) If Lotte receives 20p per mile**

		£
Mileage allowance claimed	12,000 × 20p	2,400
AMAP First 10,000 miles	10,000 × 45p	(4,500)
Remaining 2,000 miles	2,000 × 25p	(500)
		<hr/>
Mileage expense claim = allowable deduction		(2,600)
		<hr/>

(b) If Lotte receives 50p per mile

		£
Mileage allowance claimed	12,000 × 50p	6,000
AMAP First 10,000 miles	10,000 × 45p	(4,500)
Remaining 2,000 miles	2,000 × 25p	(500)
		<hr/>
Mileage allowance taxable benefit		1,000
		<hr/>

Note: The passenger allowance is tax free as it is < 5p per business mile. Lotte cannot make an expense claim for the shortfall in the passenger AMAP of 1p (5p – 4p) per mile.



Test your understanding 3

Charles

Charles has the use of the car and fuel for nine months of the tax year 2023/24 (1 July 2023 to 5 April 2024).

	£
Car benefit ($£24,000 \times 37\% (W) \times 9/12$)	6,660
Less: Payment for use ($£100 \times 9$ months)	(900)
	<hr/>
	5,760
Fuel benefit ($£27,800 \times 37\% \times 9/12$)	7,715
	<hr/>
Taxable benefit	13,475
	<hr/>

Note: No reduction for contributions towards private fuel. There is no additional charge for any running costs of the car with the exception of the fuel provision.

Working: Appropriate % = $16\% + ((200 - 55) \times 1/5) = 45\%$, but restricted to 37% maximum.



Test your understanding 4

Vigorous plc

Andrea

	£
Car benefit ($£19,400 \times 14\%$)	2,716
Less: Contribution by Andrea ($£150 \times 12$)	(1,800)
	<hr/>
	916
Fuel benefit ($£27,800 \times 14\%$)	3,892
Living accommodation	
– Annual rateable value	7,000
– Additional benefit (Note 1)	1,863
– Furniture ($£6,000$ at 20%)	1,200
Mobile telephone (Note 2)	0

Notes:

- (1) The living accommodation cost in excess of £75,000 so there will be an additional benefit.

Since the property was purchased within six years of first being provided, the benefit is based on the purchase price of the property plus improvements prior to 6 April 2023.

The additional benefit is therefore £1,863 ((£143,800 + £14,000) – £75,000 = £82,800 at 2.25%).

- (2) The provision of one mobile telephone does not give rise to a taxable benefit, even if there is private use.

Ben

	£
Beneficial loan (Note 1)	1,800
Relocation costs (£9,300 – £8,000) (Note 2)	1,300
Car benefit (£11,200 × 27% × 6/12) (Note 3)	1,512

Notes:

- (1) The benefit of the beneficial loan using the average method is £1,856 ((£120,000 + £100,000) × 1/2 = £110,000 at 2.25% × 9/12).

Using the precise method, the benefit is £1,800 ((£120,000 at 2.25% × 3/12) + (£100,000 at 2.25% × 6/12)).

Ben will therefore elect to have the taxable benefit calculated according to the precise method.

- (2) Only £8,000 of relocation costs are exempt, and so the excess is a taxable benefit.

- (3) The relevant percentage for the car benefit is 27% (16% + 4% (charge for a diesel car) + 7% ((90 – 55) = 35 × 1/5)).

The car was only available for six months of the tax year 2023/24.

There is no fuel benefit as Ben reimburses the company for the full cost of private diesel.

Chai

	£
Van benefit (£3,960 × 10/12) (Note 1)	3,300
Fuel benefit (£757 × 10/12) (Note 1)	631
Television (Note 2)	330
Health club membership (Note 3)	150
Computer (£1,900 × 20% × 3/12) (Note 4)	95

Notes:

- (1) The van and private fuel were only available for ten months of the tax year 2023/24 so the benefit is time apportioned.
- (2) Chai will have been taxed on a benefit of £160 (£800 at 20%) in respect of the television for both the tax years 2021/22 and 2022/23.

The benefit on the sale of the television is £330 (£800 – £160 – £160 – £150), as this is greater than £100 (£250 – £150).
- (3) In-house benefits are valued according to the marginal cost. The taxable benefit in relation to the health club membership is therefore the direct costs of £150.
- (4) The computer was only available for three months so the benefit is time apportioned.

**Test your understanding 5****Workout plc**

Tutorial note: You are required to explain the tax implications for Ibrahim only, but not required to advise him which options to choose.

Company car

Ibrahim will be taxed on employment income on a car benefit of £3,450 (W1) and a fuel benefit of £6,950 (W1).

The additional income tax liability is £4,160 $((£3,450 + £6,950) \times 40\%)$.

Cash alternative

The additional salary of £500 per month will be taxed as employment income, with 40% income tax and 2% NIC.

This will leave cash of £3,480 $(£500 \times 12 = £6,000 \times 58\%)$ after tax and NIC.

Ibrahim will be paid an allowance of 30p per mile for 12,600 $(1,750 \times 12 \times 60\%)$ business miles.

Ibrahim needs to consider whether the cash salary is preferable to the company car. If he accepts the cash he will receive:

	£
Cash – additional salary	3,480
Mileage allowance	3,780
Income tax relief on shortfall (40% × £1,370)	548
	<hr/>
	7,808
Plus: Total tax no longer payable on benefits	4,160
	<hr/>
Increase in cash	11,968
	<hr/>

He needs to consider whether this is enough to buy and run his car personally. If it is, the cash alternative would appear to be better.

Relocation costs

As the £8,000 limit is not exceeded, there should not be a taxable benefit in respect of the relocation costs paid for by Workout plc. This is because Ibrahim does not live within a reasonable daily travelling distance of where he is to be employed.

The exemption covers such items as legal and estate agents' fees, stamp duty land tax, removal costs, and the cost of new domestic goods where existing goods are not available in the new residence.

Beneficial loan

Ibrahim will be taxed on the difference between the interest paid on the loan and the official rate of interest as earnings. The 'average' method of calculation gives a taxable benefit for 2023/24 of £1,890 (W2).

The additional income tax liability is therefore £756 (£1,890 at 40%).

The balance at 5 April 2024 is after taking account of 12 monthly repayments of £1,000.

Living accommodation

Ibrahim will be taxed on the provision of the living accommodation provided to him. There will be an additional benefit based on the market value of £135,000, since the house cost in excess of £75,000 and it was purchased more than six years before first being provided.

The taxable benefit will be:

	£
Rateable value	7,700
Additional benefit $(£135,000 - £75,000) \times 2.25\%$	1,350
Furniture $(£12,400 \times 20\%)$	2,480
Running costs	3,900
	<hr/>
Total accommodation benefits	15,430
	<hr/>

The income tax liability is £6,172 $(£15,430 \times 40\%)$.

Mobile telephone

The provision of one mobile telephone per employee does not give rise to a taxable benefit, even if there is private use.

Fixed telephone

If Ibrahim receives £75 per month towards his home telephone, he will be taxed on a taxable employment benefit of £900 $(12 \times £75)$. However he will be able to make an expense claim of £650 in respect of the expenditure on business calls.

The additional income tax liability is therefore £100 $(£900 - £650 = £250 \times 40\%)$.

Workings

(W1) Car and fuel benefit

CO₂ emissions = 102g/km, available all year

Appropriate % = $16\% + ((100 - 55) \times 1/5) = 25\%$

Cost = $(£19,200 - £3,000 \text{ capital contribution})$
= £16,200

	£
Car benefit $(£16,200 \times 25\%)$	4,050
Less: Monthly contribution $(£50 \times 12)$	(600)
	<hr/>
Car benefit	3,450
	<hr/>
Fuel benefit $(£27,800 \times 25\%)$	6,950
	<hr/>

(W2) Beneficial loan

	£
Loan at start of year	90,000
Loan at end of year (£90,000 – (12 × £1,000))	78,000
	<hr/>
	168,000
	<hr/>
Average loan = (£168,000 ÷ 2) = £84,000	
Taxable benefit (£84,000 × 2.25%)	1,890


Test your understanding 6
Alan
(i) Tax advantaged share options

1 July 2019	Grant of option = No tax
17 October 2023	Exercise of option = No tax
20 October 2023	CGT on disposal:

	£
Sale proceeds	5,000
Less: Cost	(2,000)
	<hr/>
Chargeable gain – 2023/24	3,000
	<hr/>

BADR is available on this gain if it is an EMI scheme as there is no requirement to hold ≥ 5% interest, the options were granted at least two years pre disposal of shares, Alan works for the company and it is a trading company.

(ii) **Non-tax advantaged share options**

1 July 2019	Grant of option = No tax	
17 October 2023	Exercise of option	
	Employment income	
	= 1,000 × (£4.50 – £2)	£2,500
		<hr/>
	Subject to income tax and NICs.	
20 October 2023	CGT on disposal:	
		£
	Sale proceeds	5,000
	Less: MV @ exercise	(4,500)
		<hr/>
	Chargeable gain – 2023/24	500
		<hr/>

BADR is not available as Alan does not hold ≥ 5% interest in the ordinary share capital and does not own the shares for at least two years.

**Test your understanding 7****Katya****Income tax computation – 2023/24**

	£	£	£
Remuneration			35,000
Lump sum		80,000	
Less: Exempt amount	30,000		
Less: Statutory redundancy pay	(5,000)		
	<hr/>	(25,000)	
		<hr/>	
Taxable amount			55,000
			<hr/>
Employment income			90,000
Property income			2,745
Dividends			1,000
			<hr/>
Total income			93,745
Less: Personal allowance			(12,570)
			<hr/>
Taxable income			81,175
			<hr/>

Analysis of income:

Dividends	Termination payment	Non-savings income
£1,000	£55,000	(£81,175 – £55,000 – £1,000) = £25,175
Income tax:		
	£	£
Non-savings – basic rate	25,175 × 20%	5,035
Dividend income – DNRB	1,000 × 0%	0
Termination payment – basic rate	11,525 × 20%	2,305
	<hr/>	
	37,700	
Termination payment – higher rate	43,475 × 40%	17,390
	<hr/>	
	81,175	
	<hr/>	
Income tax liability		<hr/> 24,730 <hr/>


Test your understanding 8
Alex

	£
Employee class 1 NICs = (£14,700 – £12,570) × 12%	256
	<hr/>
Employer's class 1 NICs = (£14,700 – £9,100) × 13.8%	773
	<hr/>

Sakura

	£
Employee class 1 NICs	
(£50,270 – £12,570) × 12%	4,524
(£57,800 – £50,270) × 2%	151
	<hr/>
	4,675
	<hr/>
Employer's class 1 NICs = (£57,800 – £9,100) × 13.8%	6,721
	<hr/>
Employer's class 1A NICs = £9,600 × 13.8%	1,325
	<hr/>

Total employer's class 1 NICs

	£
Employer's class 1 NICs (£773 + £6,721)	7,494
Less: Employment allowance	(5,000)
	<hr/>
	2,494
	<hr/>

Property income, investment income and personal financial management

Chapter learning objectives

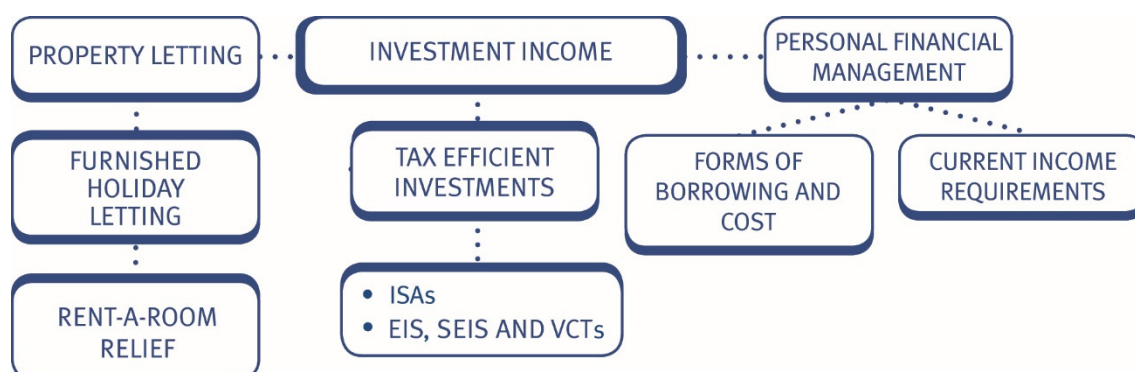
Upon completion of this chapter you will be able to:

- understand and apply the rules relating to investments in the seed enterprise investment scheme and the enterprise investment scheme
- understand and apply the rules relating to investments in venture capital trusts
- understand and apply enterprise investment scheme and seed enterprise investment scheme reinvestment relief
- explain the tax treatment of a variety of different sources of property income
- understand and compare and contrast the tax treatment of the sources of finance and investment products available to individuals
- identify and advise on the types of investment and other expenditure that will result in a reduction in tax liabilities for an individual and/or a business
- advise on legitimate tax planning measures, by which the tax liabilities arising from a particular situation or course of action can be mitigated

- advise on the appropriateness of such investment, expenditure or measures given a particular taxpayer's circumstances or stated objectives
- advise on the mitigation of tax in the manner recommended by reference to numerical analysis and/or reasoned argument.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts, such as property and investment income. Another of the PER performance objectives (PO17) is to advise on mitigating and deferring tax liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.



Introduction



This chapter is mainly a revision of the main types of exempt income and the income tax implications of letting property covered at TX.

A brief reminder of the TX content is given in supplementary reading and revision examples are provided to check your retention of the required TX knowledge.

The new topics introduced at ATX are real estate investment trust income and tax efficient investments such as EIS, SEIS and VCT investments.

1 Property income

All income from land and buildings is taxed on individuals as property income.

Property income includes:

- rental income under any lease or tenancy agreement less allowable expenses
- the premium received on the grant of a short lease
- profits arising from the commercial letting of furnished holiday accommodation
- rental income received under the rent-a-room scheme.

Rental income

A reminder of the rules for computing taxable rental income under a lease or tenancy agreement covered at TX is summarised below and in the diagram in section 5.

Basis of assessment

If an individual or partnership lets out a property or several properties, the profit from renting the properties is calculated as if the individual had a single trade:

	£
Rental income from all properties	X
Less: Related expenses (see below)	(X)
	<hr/>
Taxable property income	X
	<hr/>

- The rental income is taxable on a **cash basis** (i.e. rental income actually received during the tax year).
- The related expenses are deductible on a **cash basis** (i.e. expenses actually paid during the tax year).
- Alternatively, the taxpayer can **elect** to be taxed on the **accruals basis** (i.e. rental income earned less related expenses incurred during the tax year). If the taxpayer's gross annual rents exceed £150,000, the accruals basis must be used.
- Note that property income is always calculated on the accruals basis for a company – see Chapter 2.



In an exam question involving property income for individuals or partnerships, you should assume that the cash basis is to be used unless you are told otherwise.

- If a landlord lets more than one property, the same basis (i.e. cash or accruals) must be used for all properties. It is not possible to use the accruals basis for some properties and not others within a single business.
- It is also possible in certain circumstances for unincorporated businesses (i.e. sole traders or partnership businesses) to elect to calculate trading profit under the cash basis. This is covered in Chapter 21.

If an individual runs a trading business and has a property business, there is no need for the same basis of assessment to be chosen for both.

- Property income is taxed at 20%/40%/45% as 'non-savings income'.

Allowable deductions

The expenses allowable against the rental income are computed under the normal rules for the assessment of trading income.

- To be allowable, the expenses must be incurred wholly and exclusively for the purposes of the property business. This covers items such as:
 - insurance
 - agents fees and other management expenses
 - repairs

- interest on a loan to acquire or improve the property (subject to special rules – see below)
- irrecoverable debts (allowed under accruals basis only; under the cash basis the outstanding amount receivable would not have been taxed).
- Any expenditure incurred before letting starts is allowable under the normal pre-trading expenditure rules.



Property not let at a full rent

Where property is not let at a full rent (e.g. to a relative) a portion of the expenses incurred will be disallowed as not being wholly and exclusively incurred for the business.

For example, if rent charged is £250 p.a. but a commercial rent would be £1,000 p.a., only 25% of expenses will be allowed.

In practice, HMRC would allow the expenses but only up to the amount of the rent on that property.

- **If property is occupied for part of the year by the owner**, any expenses relating to the private use will not be allowed as a deduction.

Capital expenditure

Under the **cash basis** there is generally no distinction between capital and revenue expenditure in respect of plant and machinery and equipment for tax purposes.

- Expenditure on plant and machinery (except cars) **used in a property business**, such as tools used for maintenance of the property or office equipment used for running the business is an **allowable deduction** from income when **paid**.
- However, this general rule does not apply to:
 - cars
 - assets provided for use in a **residential property** e.g. furniture, TV (but see replacement domestic items relief below).
- In addition, capital expenditure on land and buildings is not an allowable deduction. In this case it is important to distinguish between improvements (capital expenditure) and repairs (revenue expenditure).
 - Repairs expenditure is allowable.
 - Improvement expenditure is not allowable.

Under the **accruals basis** the only difference is that expenditure on plant and machinery **used in a property business**, such as tools used for maintenance of the property or office equipment used for running the business is **not an allowable deduction** from income. However, **capital allowances** are available instead (see Chapter 21).

Cars

- Capital allowances are available on the capital cost of the cars. In this case, the actual motoring costs e.g. petrol and insurance are also deductible.
- Alternatively, HMRC's approved mileage allowances can be claimed instead of capital allowances and actual motoring costs.

These approved mileage allowances are the same as those that can be used by employees and traders to calculate allowable motoring costs (see Chapters 17 and 21).



The HMRC approved mileage allowances are included in the tax rates and allowances provided to you in the examination.

Replacement domestic items relief

As stated, expenditure on assets provided for use in a **residential property** (e.g. furniture, TV) is not allowable. In addition, capital allowances are also not available.

However, for **furnished residential** lettings a special relief, **replacement domestic items relief** (also referred to as **replacement furniture relief**) is available.

- The relief allows a deduction for the replacement (i.e. not the original acquisition) of domestic items provided by the landlord.
- The allowable deduction is:
replacement cost less any proceeds from the disposal of the original item.
- The replacement cost allowed is limited to the cost of a similar item, excluding any improvement, but allowing for the modern equivalent. For example, if a washing machine is replaced with a washer-dryer, only the cost of a replacement washing machine would qualify for relief.
- Domestic items are those acquired for domestic use for example, furniture, furnishings, household appliances (including white goods), carpets, curtains and kitchenware. However, 'fixtures' i.e. any plant and machinery that is fixed to a dwelling, including boilers and radiators are specifically excluded.
- This relief is not available to furnished holiday lettings (see section 2) and accommodation for which rent-a-room relief has been claimed (see section 3).



Test your understanding 1

Giles owns a cottage which he lets out furnished at an annual rate of £3,600 payable on 6th of each month. During the tax year 2023/24 he incurs the following expenditure:

		£
1 May 2023	Cost of new garage	2,000
1 June 2023	Insurance for year from 5 July 2023	480
1 November 2023	Replacement freezer	380
1 December 2023	New kitchen table	200
1 March 2024	Redecoration costs	750

Notes:

- 1 The tenant was late in paying the rent for March 2024. Giles received the rent on 6 April 2024.
- 2 The insurance for the year from 5 July 2022 of £420 was paid on 1 June 2022.
- 3 The redecoration costs incurred on 1 March 2024 were not paid until 1 May 2024.

Calculate Giles' property income for the tax year 2023/24, assuming that he:

- (a) applies the cash basis method of assessment
- (b) elects to apply the accruals basis method of assessment.

Financing costs – residential properties

Owners of residential property who live in their own property do not get tax relief for their mortgage costs.

Owners of buy-to-let residential properties do not get a deduction from income for their finance costs. Instead, tax relief is given on finance costs at the basic rate (20%), as a deduction from the taxpayer's final income tax liability.

These special rules apply to loans to acquire or improve a residential let property and also to acquire equipment or assets used for the residential letting business.

The finance costs include interest payable as well as the incidental costs of obtaining the finance e.g. bank fees.

Note that these rules do not apply to companies, commercial properties or qualifying furnished holiday accommodation (see below).



Illustration 1 – Financing costs

Lidya owns a residential property that she lets out for an annual rent of £15,000. During the tax year 2023/24 she paid the following expenses:

	£
Agent's fees	1,000
Insurance	1,500
Gardener's costs	1,300
Interest costs on loan to acquire property	7,500

During the tax year 2023/24 Lidya also has trading income of £50,000 and bank interest income of £800.

Calculate Lidya's income tax liability, after reliefs, for the tax year 2023/24.

Solution

	Non-savings income	Savings income	Total
	£	£	£
Trading income	50,000		50,000
Property income (W)	11,200		11,200
Bank interest		800	800
	<hr/>	<hr/>	<hr/>
Total income	61,200	800	62,000
Less: PA	(12,570)		(12,570)
	<hr/>	<hr/>	<hr/>
Taxable income	48,630	800	49,430
	<hr/>	<hr/>	<hr/>

Income tax:

	£		£
Non-savings – basic rate	37,700	× 20%	7,540
Non-savings – higher rate	10,930	× 40%	4,372
	<hr/>		
	48,630		
Savings income – SNRB	500	× 0%	0
Savings income – higher rate	300	× 40%	120
	<hr/>		
	49,430		
	<hr/>		
			<hr/>
			12,032
Less: Basic rate tax relief on property income interest (£7,500 × 20%)			<hr/>
			(1,500)
			<hr/>
Income tax liability			10,532
			<hr/>

Working: Property income

	£	£
Rent		15,000
Less: Allowable expenses		
Agent's fees	1,000	
Insurance	1,500	
Gardener's costs	1,300	
Interest	0	
	<hr/>	
		(3,800)
		<hr/>
Property income		11,200
		<hr/>

2 Furnished holiday accommodation

Profits arising from the commercial letting of furnished holiday accommodation (FHA) are:

- taxable as property income, but
- treated as though the profits arose from a separate trade, and
- treated as earned income, not investment income.

In the same way as for a normal property, the **cash basis** should be used to calculate FHA income unless gross rental income exceeds £150,000. In the examination it should be assumed that cash basis applies unless the question states otherwise.

The conditions and rules for FHA are given below and summarised in the diagram in section 5.



Furnished holiday accommodation

Qualifying conditions

In order to qualify as a FHA, the accommodation must satisfy all of the following conditions:

- the property is situated in the UK or the EEA, **furnished** and let on a **commercial basis**
- it is **available** for commercial letting, to the public generally, as holiday accommodation for not less than **210 days** a year
- the accommodation is **actually let** for at least **105 days** a year (excluding periods of long-term occupation)
 - Where a taxpayer owns more than one property, the 105 days test is satisfied if the average number of days for which the properties are let in the year is at least 105.
- the accommodation is normally **not let for > 31 consecutive days** to the same person. However, if during a 12-month period there are periods of letting to the same person in excess of 31 consecutive days, the aggregate of these long periods **must not exceed 155 days** in total.

Losses

Losses from FHA cannot be set against any other income, they can only be carried forward and offset against profits from the same FHA business.

UK losses can only be set against future UK FHA income, and EEA losses can only be set against future EEA FHA income.

The advantages of FHA treatment

The profits will be treated as earned income arising from a single trade carried on by the landlord.

The advantages of being treated as earned income include:

- Profits treated as relevant earnings for pension relief purposes (see Chapter 19).
- Finance costs are fully deductible from income i.e. there is no restriction to basic rate relief.
- Plant and machinery:
 - a deduction is available for all plant and machinery **including furniture and furnishings** if the cash basis is used
 - if the accruals basis is used then normal capital allowances (e.g. annual investment allowance) are available.

This is instead of replacement furniture relief.

- Property is treated as a business asset for CGT purposes and consequently on the disposal of FHA the following reliefs are available (Chapter 9):
 - business asset disposal relief
 - rollover relief, and
 - gift holdover relief.
- Business property relief for IHT may be available (Chapter 11) but only if:
 - it is run as a business (for example, a caravan park or estate)
 - there is substantial involvement by the owner, and
 - additional services are provided (e.g. cleaning, laundry, TV, light and heat, activities).

3 Rent-a-room relief

When an individual lets furnished accommodation in the individual's main residence, a special exemption applies.

A reminder of the rules is given below and is summarised in the diagram in section 5.

Like other property income rent-a-room is dealt with under the **cash basis**.



Rent-a-room relief

- If the gross annual receipts (before expenses or capital allowances) are £7,500 or below:
 - the income will be exempt from tax
 - the individual can elect to ignore the exemption for that year if a loss is incurred.
- If the gross annual receipts are more than £7,500:
 - the individual may choose between:
 - (i) paying tax on the excess of the gross rent over £7,500, and
 - (ii) being taxed in the ordinary way on the profit from letting (rent less expenses less replacement furniture relief).

Married couples and civil partners

A married couple or civil partners who take in lodgers can either have:

- all the rent paid to one partner (who will then have the full limit of £7,500), or
- have the rent divided between them (and each partner will then have a limit of £3,750).



The rent-a-room relief limit is included in the tax rates and allowances provided to you in the examination.

4 Property business losses

Profits and losses on all the properties are aggregated.

- If there is an overall loss, the property income assessment for the year will be £Nil.
- The loss is automatically carried forward and set against the first available future property income.



Illustration 2 – Property business losses

Sheila owns three properties which were rented out. Her taxable income and allowable expenses for the two years to 5 April 2024 were:

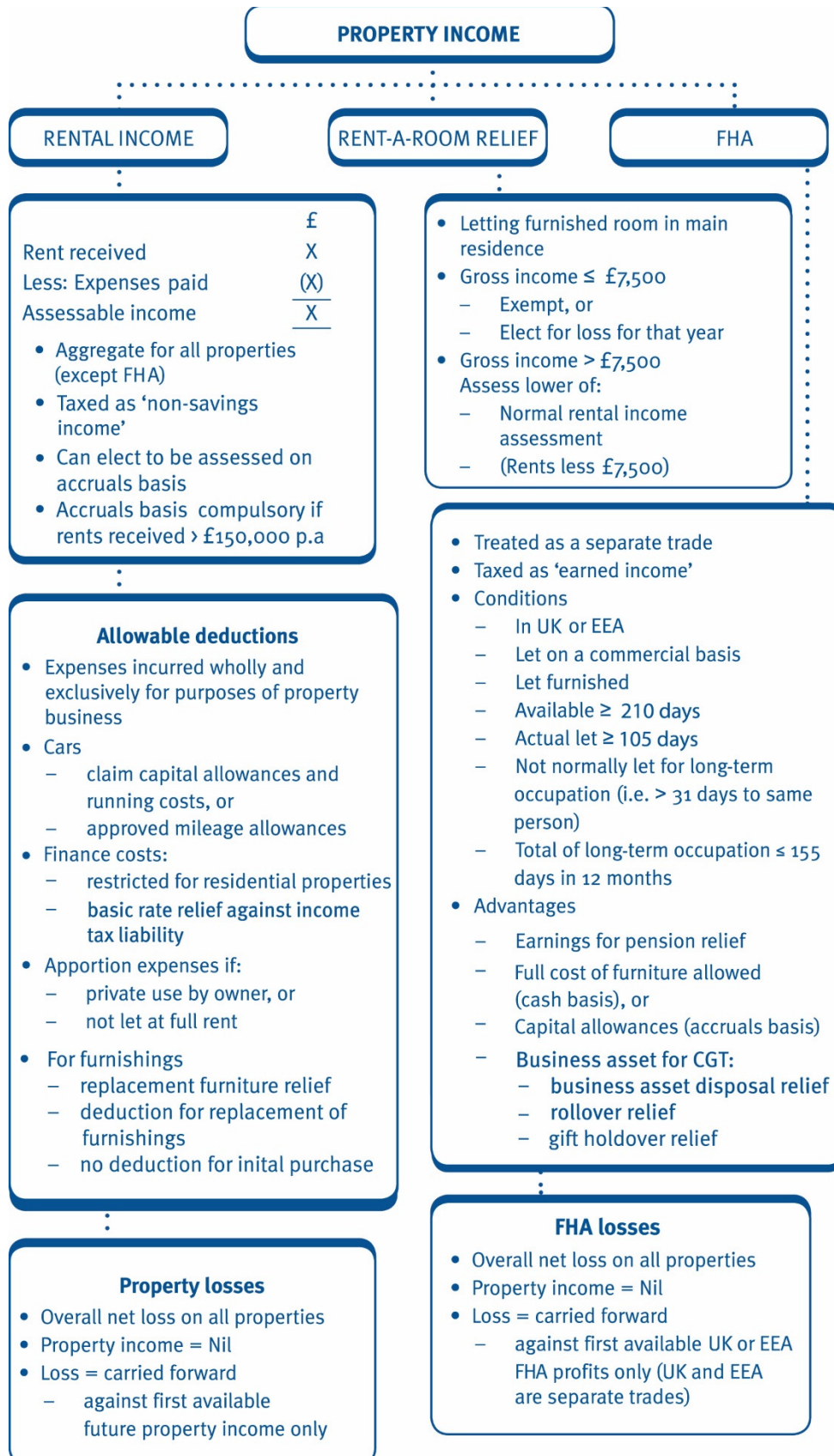
Property	1	2	3
Income	£	£	£
2022/23	1,200	450	3,150
2023/24	800	1,750	2,550
Expenses			
2022/23	1,850	600	2,800
2023/24	900	950	2,700

Calculate Sheila's property income or losses for 2022/23 and 2023/24.

Solution

Property income/losses	2022/23	2023/24
	£	£
Income		
(£1,200 + £450 + £3,150)	4,800	
(£800 + £1,750 + £2,550)		5,100
Less: Expenses		
(£1,850 + £600 + £2,800)	(5,250)	
(£900 + £950 + £2,700)		(4,550)
	<hr/>	<hr/>
Profit/(loss) in year	(450)	550
Less: Loss b/f	–	(450)
	<hr/>	<hr/>
Property income	0	100
	<hr/>	<hr/>
Loss c/f	450	0
	<hr/>	<hr/>

5 Summary



6 Premiums received on the grant of a lease

A lease premium is a lump sum payment made by the tenant to the landlord in consideration of the granting of a lease.

The receipt of a premium on the granting of:

- a short lease (≤ 50 years): has both income tax and CGT consequences
- a long lease (> 50 years) has no income tax consequences but is chargeable to CGT.

This chapter considers only the income tax consequences of granting leases, the CGT aspects of granting leases are not examinable.

Short lease premiums

A short lease is a lease for a period of 50 years or less.

- Part of a premium received on the grant of a short lease is treated as rental income the tax year in which the lease is granted, whether the cash basis or the accruals basis is used.
- The amount taxable as property income is:

	£
Premium	X
Less: Premium $\times 2\% \times (\text{duration of lease} - 1)$	(X)
	—
Property income	X
	—

Duration of lease = number of **complete** years (ignore parts of a year).

- Alternative calculation:
 $\text{Premium} \times (51 - n)/50$
 where n = length of lease (in whole years).



Length of lease

To avoid income tax, it would be a simple matter to grant a lease for over 50 years, but to give the landlord the right to end the lease before the expiration of 50 years.

Anti-avoidance legislation provides that where the lease can be terminated at some date during the lease, the period of the lease is taken to the **earliest** date on which the lease **may** be terminated.



Test your understanding 2

Rodney granted a 21-year lease of business premises to Precious on 1 July 2023 for a premium of £10,500.

He also granted a lease for another building with 14 years and 2 months left to run to Alice for a premium of £30,000 in October 2023.

Calculate Rodney's property income assessment for the tax year 2023/24.

Comprehensive example



Test your understanding 3

Jian acquired two houses on 6 April 2023.

House 1 is let as furnished holiday accommodation. House 2 is let furnished.

House 1 was available for letting for 42 weeks during the tax year 2023/24 and was actually let for 16 weeks at £200 per week. During the 10 weeks that the house was not available for letting, it was occupied rent-free by Jian's sister. Running costs for the tax year 2023/24 consisted of council tax £730, insurance £310 and advertising £545.

House 2 was unoccupied from 6 April 2023 until 31 January 2024 due to a serious flood in May 2023. As a result of the flood £7,465 was spent on repairs.

On 1 February 2024 the house was let on a four-year lease for a premium of £4,000 and a rent of £8,600 per annum, receivable quarterly in advance.

Immediately after the purchase, Jian furnished the two houses at a cost of £5,200 per house. During 2023/24 Jian also rented out one room of his main residence. He received rent of £7,850 and incurred allowable expenditure of £825.

- (i) **Briefly explain whether House 1 will qualify to be treated as a trade under the furnished holiday accommodation rules.**

State the tax advantages of the house being so treated.

- (ii) **Calculate Jian's property loss for the tax year 2023/24 and advise him of the possible ways of relieving the loss.**



7 Real estate investment trusts

A real estate investment trust (REIT) gives investors the opportunity to invest in a quoted property business set up as an investment trust.

A REIT can elect for any income or gains from its investment properties to be exempt from corporation tax.

Dividends received by an individual out of the profits of a REIT are not treated like other dividend income. Instead the income is:

- treated as property income
- taxed as non-savings income (i.e. not savings and not dividend income)
- received net of 20% tax.



Illustration 3 – Real estate investment trusts

An individual who receives dividends of £1,200 from a REIT will include gross property income in his, her or their tax return of £1,500 ($£1,200 \times 100/80$).

The income will be taxed at the rates of 20%, 40% or 45% depending on whether the individual pays tax at the basic, higher or additional rate.

A tax credit of £300 ($£1,500 \times 20\%$) is available to reduce the actual tax payable, and can be repaid if relevant.

8 Tax free investments

The main types of investment giving tax free or exempt income are as follows:

- interest on NS&I savings certificates
- income from individual savings accounts (ISAs)
- dividends from shares held in a venture capital trust (VCT)
- income tax repayment supplement
- premium bond, national lottery and betting winnings.

Individual savings accounts (ISAs)

An ISA can be opened by any individual aged 18 or over (16 for cash ISAs) who is resident in the UK.

An ISA offers the following tax reliefs:

- Income (interest and dividends) received is exempt from income tax.
- Disposals of investments within an ISA are exempt from CGT.

There is no minimum holding period, so withdrawals can be made from the account at any time.

A reminder of the rules for the type of investment allowed through an ISA is given below.



Types of investments

An ISA can be made up of either of the following components:

- Cash and cash-like equity products

These include bank and building society accounts, as well as those NS&I products where the income is not exempt from tax.

16 and 17 year olds may only invest in cash ISAs.

- Stocks, shares and insurance products

Investment is allowed in shares and securities listed on a stock exchange anywhere in the world.

Unlisted shares and shares traded on the Alternative Investment Market (AIM) do not qualify.

Subscription limits



For the tax year 2023/24 the annual subscription limit and maximum amount that can be invested by an individual in an ISA is £20,000.

Note that spouses and civil partners each have their own limits.

This ISA limit is included in the tax rates and allowances provided in the examination.

Any combination of cash and shares can be invested, up to the total of £20,000.

Savers can also withdraw money from a cash ISA and replace it in the same tax year without the replacement contributing to their maximum investment. This is only available on certain cash ISAs.

Savers have a choice of account providers.

ISAs and the income tax nil rate bands

The tax advantages of ISAs have been removed for many taxpayers by the introduction of the savings income nil rate band (SNRB) and the dividend nil rate band (DNRB):

Cash ISAs

- For many basic and higher rate taxpayers, the introduction of the savings income nil rate band (SNRB) means that investing in a cash ISA no longer provides a tax benefit. This is because their savings income is within the SNRB and is therefore taxed at 0%.
- ISAs will still be beneficial for additional rate taxpayers (who are not entitled to a SNRB) and all taxpayers whose SNRB is already fully utilised.

Stocks and shares ISAs

- For many individuals, the availability of the dividend nil rate band (DNRB) means that investing in a stocks and shares ISA does not provide an income tax benefit. This is because their dividend income is within the DNRB and is therefore taxed at 0%.
- Stocks and shares ISAs will still be beneficial for taxpayers whose DNRB is already fully utilised. In addition, chargeable gains made within a stocks and shares ISA are exempt from capital gains tax and will therefore be advantageous to taxpayers who make chargeable gains in excess of the annual exempt amount.



Transfer of ISA allowance to spouse or civil partner on death

An additional allowance can be claimed for the surviving spouse or civil partner.

- The amount of the allowance will be equal to the value of the deceased person's ISA savings at the time of death.

This means that ISA savings can be transferred to the surviving spouse and retain their beneficial tax treatment.

Note that:

- spouses will be entitled to the allowance even if the ISA assets are left to someone else
- a claim must be made for the additional allowance.



9 Enterprise investment scheme

The enterprise investment scheme (EIS) is intended to encourage investors to subscribe for new shares in unquoted trading companies.

- Since the investor is committing the whole investment to one company, which may well not yet have a track record, this is a high-risk investment.
- Furthermore, unless the shares become quoted, the investor may not be able to realise the investment easily. A successful company, however, may carry high returns.

To qualify for the scheme:

- the **investor** must
 - subscribe, in cash, for new ordinary shares in a qualifying company
 - **not** be an **employee** or director of the company
 - be independent of the company at the time of the first share issue (i.e. **not** already hold shares in the company at the time of investment, unless the shares held by the investor are qualifying EIS or Seed EIS shares)
 - have an **interest of 30% or less** in the company's ordinary share capital (OSC).



There are also conditions that a company must meet in order to qualify as an EIS company, but these conditions are **not examinable**.

Tax consequences

Income tax

- **Income tax relief = 30% × (cost of the shares subscribed for)**
 - Maximum investment = **£1 million per tax year**
 - Therefore, maximum tax reducer = £300,000
 - **Deduct from** the individual's **income tax liability**
 - Can reduce liability to £Nil, but cannot create a tax repayment.
- An investor may elect to carry back the amount invested to the previous year, but cannot get relief on more than £1 million in any one tax year.
- Claims for EIS income tax relief are normally made on the self-assessment tax return but can be made up to five years after 31 January following the end of the tax year in which the shares are issued, (31 January 2030 for shares issued in the tax year 2023/24).
- Note that dividends received from an EIS investment are taxable in the normal way.



There are different rules for investment in knowledge-intensive companies, but these rules are **not examinable**.



Test your understanding 4

Talia is not an employee of A Ltd and does not currently own any shares in A Ltd. Talia subscribes for 10,000 new ordinary shares in A Ltd (a 1% interest) for £30,000 on 30 June 2023.

A Ltd is a qualifying EIS company.

Talia's income tax liability in the tax year 2023/24 is £14,000.

Show the amount of EIS relief allowable for the tax year 2023/24, assuming Talia does not wish to carry back the relief to the tax year 2022/23.

Capital gains tax

- Capital gains on the disposal of shares in qualifying companies are exempt provided the shares have been held for **three years**, but capital losses are always allowable.
- When calculating a capital loss on disposal of EIS shares, the cost of the shares must be reduced by the amount of EIS relief that was claimed and has not been withdrawn (see later regarding withdrawal of relief).
- An election can be made for capital losses to be relieved against total income in the same way as trading losses (see Chapter 8).

Capital gains tax – EIS reinvestment relief

- If the proceeds from the disposal of a chargeable asset are reinvested in EIS shares, it is possible to **defer** some, or all, of the gain arising on the asset.

The operation of the relief

EIS reinvestment relief operates as follows:

- The individual can choose to defer:
 - **any** amount of any capital **gain** on **any** asset
 - if qualifying EIS shares are subscribed for
 - the relief cannot exceed the amount invested.
- The relief is therefore the lowest of:
 - the gain
 - the amount invested in EIS shares
 - any smaller amount chosen.
- Any amount not deferred is charged to CGT in the normal way.

- The deferred gain is
 - not deducted from the base cost of the EIS shares
 - the gain is simply 'frozen' and becomes chargeable on the occurrence of one of the events listed later in this section.
- Although the CGT on the disposal is only deferred, the initial relief is effectively 40% or 50% (30% income tax on the EIS investment, and 10% or 20% CGT deferred).
- Any gain arising on the actual EIS shares disposed of is exempt from CGT, provided the shares have been held for at least three years.
- EIS reinvestment relief is not automatic and must be claimed.

Occasions when the deferred gain becomes chargeable

Any of the following will cause the deferred gain to become chargeable:

- **EIS shares are disposed of by:**
 - the investor, or
 - the investor's spouse or civil partner (following a previous no gain/no loss transfer)
 - where only part of the holding is disposed of, only a corresponding part of the deferred gain will become chargeable.
- **Within three years** of the issue of shares:
 - the investor, or
 - the investor's spouse or civil partner (following a previous no gain/no loss transfer)

becomes non-UK resident (e.g. emigrates abroad) unless

 - working temporarily outside the UK (i.e. resumes UK residence within three years), and
 - retains the shares throughout.

Conditions for EIS relief

To qualify for EIS relief:

- The individual must be UK resident when the gain arises and when the reinvestment is made.
- The reinvestment must be:
 - subscribing for new shares
 - wholly for cash
 - in an unquoted trading company trading wholly or mainly in the UK.
- The reinvestment must be made within a **four-year** time period which runs from **12 months before** to **36 months after** the date the gain arose.
- The claim must be made by 31 January 2030 for 2023/24 disposals.

Note that:

- for EIS income tax relief there is a maximum investment of £1 million. However, there is no maximum amount for the purposes of this CGT reinvestment relief. The relief is effectively unlimited.
- the relief is flexible, any amount of reinvestment relief can be claimed. Therefore, the individual should choose an amount of relief so that the remaining gain is equal to any capital losses and AEA available.



Test your understanding 5

Precious sold a painting in November 2023 for £275,000 realising a capital gain of £150,000.

Precious subscribes for qualifying EIS shares in Milan Ltd, a trading company, the following month at a cost of £268,000. She has no other capital transactions for the tax year 2023/24, but has capital losses brought forward from the tax year 2020/21 of £12,000.

Three years later in the tax year 2026/27 Precious sells the EIS shares making a profit of £175,000.

- Calculate the amount of reinvestment relief that Precious should claim.**
- Explain the capital gains tax consequences of the sale of the EIS shares in the tax year 2026/27.**

Interaction with business asset disposal relief

If the asset disposed of does not qualify for BADR (see Chapter 9), the deferred gain will be taxed at 10%/20% when it becomes chargeable.

If the asset qualifies for BADR then the taxpayer may choose to either:

- claim BADR at the time of disposal and pay tax on the eligible gain at 10% in the year of disposal, or
- claim EIS reinvestment relief and defer the gain until the EIS shares are sold (usually).

If BADR would be available but is not claimed at the time of disposal and the gain is deferred:

- the deferred gain will **still be taxed at 10% when it becomes chargeable**
- provided a claim is made within 12 months of the 31 January following the end of the tax year in which the gain actually becomes chargeable.

The decision to claim BADR at the time of the disposal or defer the gain and claim BADR later will depend on the cash flow position of the taxpayer, but there is clearly a cash flow benefit to be gained from deferring the gain.

In addition, a further AEA may be available to set against the deferred gain when it becomes chargeable.



Test your understanding 6

Christine sold her 10% holding in Cracker Ltd in September 2023 for £750,000, realising a capital gain of £250,000.

She acquired the shares in July 2020 and has been a director of Cracker Ltd throughout her period of ownership.

In November 2023 she subscribed for qualifying EIS shares in Cream Ltd, a trading company, at a cost of £375,000.

Christine had no other capital transactions in the tax year 2023/24 but has capital losses brought forward of £56,000.

Calculate the amount of EIS reinvestment relief that Christine should claim in the tax year 2023/24 and discuss the interaction with business asset disposal relief.

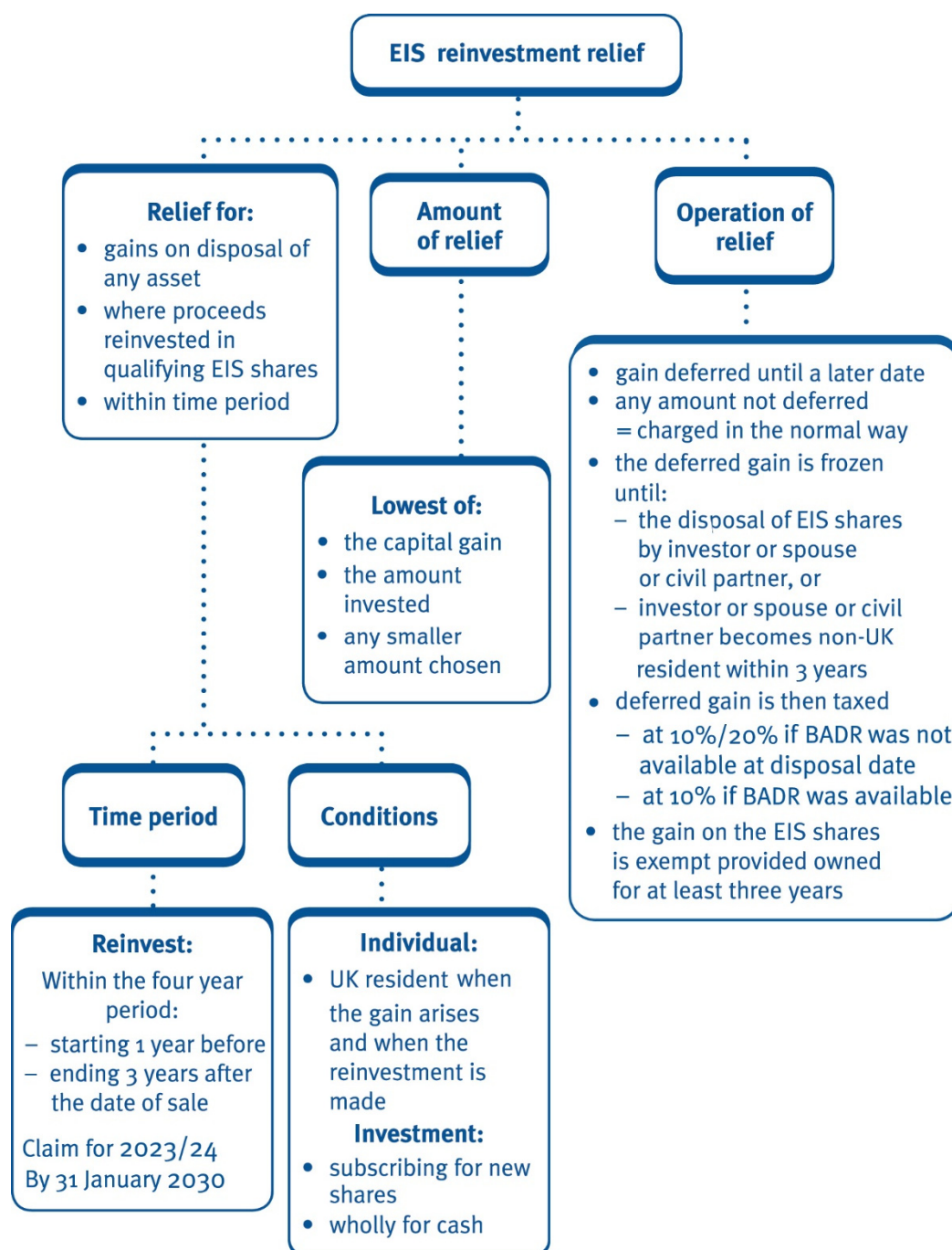
Withdrawal of EIS relief

- The income tax relief is withdrawn if the EIS shares are not held for a minimum period of three years.
- If the investor sells the shares within three years the investor must repay to HMRC the income tax relief given, as follows:

	Not at arm's length	At arm's length
IT relief withdrawn (i.e. amount of IT that becomes payable)	All original IT relief given	Lower of: <ul style="list-style-type: none"> • original IT relief given • $(30\% \times \text{sale proceeds received for shares})$

- Any income tax relief claimed and **not** withdrawn is deducted from the cost of the shares for CGT purposes.

Summary – EIS reinvestment relief



Inheritance tax

- Shares in an EIS scheme qualify for business property relief (BPR) as they are unquoted shares, provided they have been owned for two years (see Chapter 11).



10 The Seed enterprise investment scheme (SEIS)

This scheme, similar to EIS, is designed to encourage investment in smaller start-up companies.

To qualify for the scheme:

- the **investor** must:
 - subscribe, in cash, for new ordinary shares in a qualifying company
 - **not** be a current **employee** (but can be a director or previous employee)
 - have an **interest of 30% or less** in the company's OSC.



There are also conditions that a company must meet in order to qualify as an SEIS company, but these conditions are **not examinable**.

Tax consequences

Income tax

The reliefs available for the investor are as follows:

- **Income tax relief = 50% × (cost of the shares subscribed for)**
 - Maximum investment = **£100,000 per tax year**
 - Therefore, maximum tax reducer = £50,000
 - **Deduct from the individual's income tax liability**
 - Can reduce liability to £Nil, but cannot create a tax repayment.
- An investor may elect to carry back the amount invested to a previous year, but cannot get relief on more than £100,000 in any one tax year.
- Claims for SEIS income tax relief are normally made on the self-assessment tax return but can be made up to five years after 31 January following the end of the tax year in which the shares are issued, (31 January 2030 for shares issued in the tax year 2023/24).



Test your understanding 7

Imran subscribes for qualifying SEIS shares costing £60,000 in 2023/24 and has an income tax liability of £37,000.

Show the SEIS relief available for the tax year 2023/24 assuming Imran does not wish to carry back the relief to 2022/23.

Capital gains tax

- Like the EIS scheme:
 - **gains** on shares held for at least **three years** will be **exempt**, and
 - an election can be made for capital losses to be relieved against total income in the same way as trading losses (see Chapter 8).

Capital gains tax – SEIS reinvestment relief

SEIS reinvestment relief works differently from EIS reinvestment relief, although in many respects it is the same.

If an individual:

- disposes of **any** chargeable asset which gives rise to a gain, and
- reinvests the proceeds in qualifying SEIS shares, and
- qualifies for SEIS income tax (IT) relief in the same tax year

some of the gain arising is **exempt** from capital gains tax (not deferred).

Any remaining gain is taxable in the normal way.

Note that if an investor elects to carry back the amount invested in SEIS shares to the previous tax year for the purposes of SEIS income tax relief, this will also apply for the purposes of SEIS reinvestment relief.

This means that:

- if an investment in SEIS shares was made in the tax year 2023/24, but
- a claim was made to carry back the investment and claim IT relief in the tax year 2022/23

reinvestment relief would be available in respect of gains made in the tax year 2022/23.

The operation of the relief

The maximum SEIS exemption = **50% of the lower of:**

- (i) the amount of the gain
- (ii) the amount reinvested in qualifying SEIS shares on which IT relief is claimed.

As the maximum amount that can qualify for IT relief is £100,000, the **maximum CGT exemption is £50,000**.

The relief must be claimed (it is not automatic), but is flexible, as any amount up to the maximum reinvestment relief can be claimed.

Therefore, if applicable, the individual should choose an amount of relief so that the remaining gain is equal to any capital losses and AEA available.

The time limits for making the claim are the same as for EIS reinvestment relief (i.e. by 31 January 2030 for disposals in the tax year 2023/24).



Test your understanding 8

Zosia sold an antique vase in June 2023 for £150,000 realising a capital gain of £75,000. In August 2023 she subscribed for qualifying SEIS shares in Browns Ltd.

She has no other capital transactions for the tax year 2023/24, but has a capital loss brought forward of £22,000.

- (a) **Calculate Zosia's taxable gains for the tax year 2023/24 assuming the SEIS shares cost:**
- (i) **£60,000**
 - (ii) **£125,000**
- (b) **Explain the capital gains tax consequences if Zosia sells the SEIS shares in 2028.**

Withdrawal of SEIS relief

- If the investor sells the shares within three years then the income tax relief and any CGT reinvestment relief will be withdrawn, as follows:

	Not at arm's length	At arm's length
IT relief withdrawn (i.e. amount of IT that becomes payable)	All original IT relief given	Lower of: <ul style="list-style-type: none"> original IT relief given $(50\% \times \text{SP received for shares})$
CGT relief withdrawn (i.e. previously exempted gain that becomes chargeable)	All of the gain previously exempted	<ul style="list-style-type: none"> A proportion of the gain previously exempted Proportion = $\frac{\text{Amount of IT relief withdrawn (above)}}{\text{Original IT relief given}}$

- Any income tax relief claimed and **not** withdrawn is deducted from the cost of the shares for CGT purposes.



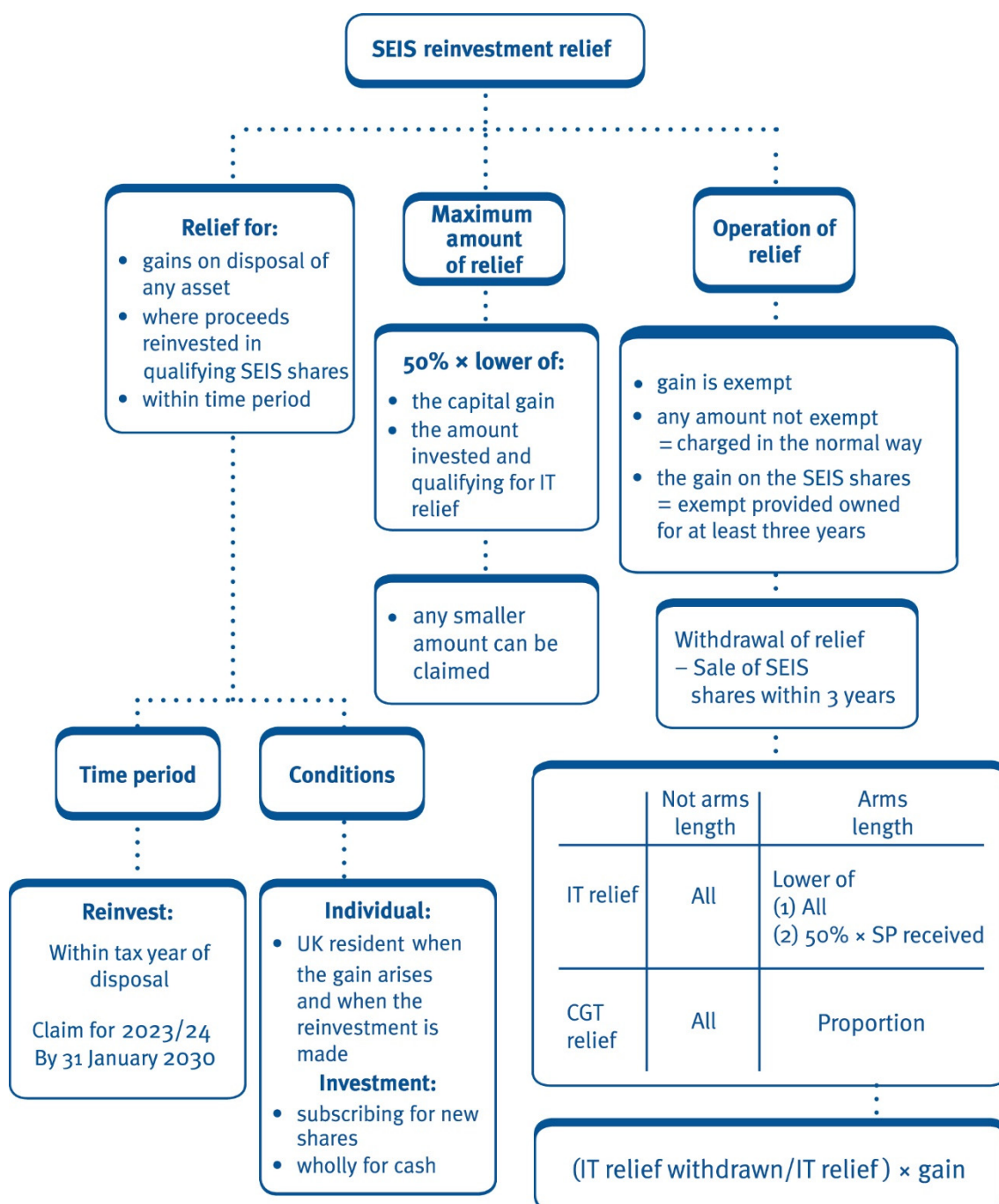
Test your understanding 9

Explain the tax consequences for Zosia (in Test Your Understanding 8) assuming that in 2025 she sells all of the SEIS shares for £65,000:

- (a) **To her sister, not in an arm's length transaction.**
- (b) **To her friend, in an arm's length transaction.**

Consider both of the scenarios where she originally subscribes for shares at a cost of £60,000, and at a cost of £125,000.

Summary – SEIS reinvestment relief



Inheritance tax

- Shares in an SEIS scheme qualify for business property relief as they are unquoted shares, provided they have been owned for two years (see Chapter 11).



11 Venture capital trusts

Relief for investment in venture capital trusts (VCTs) was introduced to encourage individuals to provide capital for unquoted trading companies.

The VCT is a quoted company that buys shares in EIS companies and so an individual is able to invest in a **spread** of unquoted companies, thus reducing the risk involved.

Tax consequences

Income tax

- **Income tax relief = 30% × (cost of the shares subscribed for)**
 - Maximum investment = **£200,000 per tax year**
 - Therefore, maximum tax reducer = £60,000
 - **Deduct from the individual's income tax liability**
 - Can reduce liability to £Nil, but cannot create a tax repayment.
- No carry back facility.
- **Claim** relief within four years of the end of the tax year of investment (i.e. by **5 April 2028** for shares purchased in the tax year 2023/24)
- **Dividend** income from a VCT = **exempt** from income tax for investments up to £200,000 p.a.

Capital gains tax

- Capital gains on the disposal of shares in a VCT are exempt for investments of up to £200,000 p.a.
- No relief for capital losses.
- No deferral relief available.

Inheritance tax

- Shares in a VCT do **not** qualify for business property relief.

Withdrawal of VCT relief

- The income tax relief is withdrawn if the shares are not held for a minimum period of **five** years, as follows:

	Not at arm's length	At arm's length
IT relief withdrawn (i.e. amount of IT that becomes payable)	All original IT relief given	Lower of: <ul style="list-style-type: none"> • original IT relief given • (30% relief × sale proceeds received for shares)

Comparison of EIS, SEIS and VCT

	Enterprise investment scheme (EIS)	Seed EIS (SEIS)	Venture capital trust (VCT)
Level of risk	<ul style="list-style-type: none"> • High • Only one company invested in 		<ul style="list-style-type: none"> • Not as high • Risk spread over a number of investments
Qualifying individual	<ul style="list-style-type: none"> • Subscribes in cash • New ordinary shares • Qualifying company • Owns $\leq 30\%$ of ordinary share capital 		<ul style="list-style-type: none"> • Subscribes in cash • Newly issued shares
	<ul style="list-style-type: none"> • Not employee or director • Independent of company prior to first issue 	<ul style="list-style-type: none"> • Not current employee (can be director or previous employee) 	
Max investment by individual	<ul style="list-style-type: none"> • £1 million p.a. 	<ul style="list-style-type: none"> • £100,000 p.a. 	<ul style="list-style-type: none"> • £200,000 p.a.
Retention period for IT relief	<ul style="list-style-type: none"> • IT relief withdrawn if sold within 3 years 		<ul style="list-style-type: none"> • IT relief withdrawn if sold within 5 years
IT relief: deduct from IT liability	<ul style="list-style-type: none"> • 30% of amount subscribed 	<ul style="list-style-type: none"> • 50% of amount subscribed 	<ul style="list-style-type: none"> • 30% of amount subscribed
Carry back amount to previous year	<ul style="list-style-type: none"> • Any amount invested • No relief on an investment of $> £1$ million in any one tax year 	<ul style="list-style-type: none"> • Any amount invested • No relief on an investment of $> £100,000$ in any one tax year 	<ul style="list-style-type: none"> • No carry back
Dividend income	<ul style="list-style-type: none"> • Taxable 		<ul style="list-style-type: none"> • Exempt

	Enterprise investment scheme (EIS)	Seed EIS (SEIS)	Venture capital trust (VCT)
CGT on disposal	<ul style="list-style-type: none"> Gain – exempt if held ≥ 3 years Loss – allowable – can elect to convert into an IT loss 		<ul style="list-style-type: none"> No gain or loss regardless of when sold
CGT relief	<ul style="list-style-type: none"> Gain on any chargeable asset deferred if proceeds reinvested in EIS shares Gain crystallises when EIS shares disposed of 	<ul style="list-style-type: none"> Up to max of 50% of the gain on any chargeable asset = exempt Relief withdrawn if SEIS shares sold within 3 years 	<ul style="list-style-type: none"> No relief
IHT – BPR	<ul style="list-style-type: none"> 100% if owned ≥ 2 years 		<ul style="list-style-type: none"> No BPR

12 Comprehensive example



Test your understanding 10

Matthew has the following investment income in addition to trading income of £90,000:

- Dividends from VCT investment of £3,000
- Dividend from REIT of £4,992
- Dividend from IIP trust of £2,205
- Discretionary trust income of £3,300
- Bank interest of £458

Both trusts' assets comprised of quoted shares only. He also invested £50,000 in a qualifying EIS scheme during the tax year.

He has paid private pension contributions during the period of £13,260.

Calculate the income tax liability for the tax year 2023/24.

13 Mitigating income tax liabilities

Tax efficient income

As there are different forms of income the areas of consideration will vary, however some of the key aspects to consider are:

- the range of exempt sources of income,
- the range of tax-exempt benefits, as covered in Chapter 17
- the different tax rates on alternative sources of taxable income, as revised in Chapter 16.



Illustration 4 – Tax efficient income

Danka is a higher rate tax payer. She has recently inherited various investment assets with a projected annual income comprising:

£10,000 UK dividends from quoted and unquoted shares.

£5,000 building society interest.

She wishes to minimise her income tax liability through a consideration of alternative forms of similar investments.

Identify two suitable investments that will reduce Danka's future income tax liability.

Solution

As a higher rate taxpayer, Danka will be entitled to a £500 savings income nil rate band (SNRB). All taxpayers are entitled to a £1,000 dividend nil rate band (DNRB). Danka's savings and dividend income exceeds these nil rate bands. Therefore, she should consider investing assets generating income in excess of the nil rate bands in an ISA.

An individual has the opportunity each tax year to invest in an ISA. The maximum annual investment is £20,000 in stocks and shares or cash, in any combination.

All income, both dividend and interest, is tax-free. Therefore, use of this facility each tax year could be recommended as it means the income will become tax-free.

She could also consider using the venture capital trust scheme. This quoted investment provides both tax free dividends and income tax relief at a rate of 30% on investments up to £200,000 p.a.

Tax efficient expenditure

An individual can obtain tax relief on certain types of expenditure. The rate of the relief and the precise treatment of each varies in the income tax computation, but the key types are summarised below:

Type	Maximum tax relief	Treatment in IT computation	Details in:
Personal pension scheme	45%	For HR and AR payers only – extend BR band and HR limit	Chapter 19
Occupational pension contributions	45%	Relief through PAYE	Chapter 19
Qualifying loan interest	45% on up to greater of: – £50,000 or – 25% of ATI	Deduct from total income	Chapter 16
EIS/SEIS	30%/50% on up to £1 million/ £100,000 investment	Tax reducer – deduct from IT liability	Chapter 16 and sections 9 and 10
VCT	30% on up to £200,000 investment	Tax reducer – deduct from IT liability	Chapter 16 and section 11

14 Personal financial management

The requirements of individuals when considering investments will change during their lifetimes, partly as their lifestyles change but also as their income increases.

When considering investments, the main factors that need to be considered are usually:

- what income is available to invest after meeting the current outgoings from the individual's existing income?
- does the taxpayer want to own a home, and if so how should the purchase be financed?
- where the individual is responsible for children, will money be needed to fund school fees or university education, and how soon will this be needed?
- is the individual responsible for supporting elderly parents now, or at some time in the future?

- ensuring there is sufficient income to fund the individual's lifestyle after retirement from employment or self-employment
- building a portfolio of investments that the individual may wish the children to inherit after death
- ensuring some investments are readily realisable if there is an unforeseen immediate need for cash (e.g. a cash ISA)
- is it likely that the individual will inherit assets from family members at some time in the future, which could be used to fund asset purchases or living expenses during retirement?
- what is the individual's attitude to risk and ethical investment?

These considerations mean that in most cases it will be necessary to balance the requirement for income on an on-going basis, and investing for capital growth to be used to fund retirement.

An important issue is the tax treatment of any income or growth.

As a general rule:

- income will be liable to income tax
 - however, some income is exempt, or
 - could be tax-free if it is covered by the personal allowance or savings or dividends nil rate bands.
- capital growth will be liable to CGT
 - the AEA is a very important factor when deciding what the overall tax charge will be
 - some investments attract an exemption from CGT.

However, the taxpayer must not allow the tax treatment to be the only consideration when deciding on the type of investment to make.

Individuals should also consider:

- the potential risks involved.
For example, this could include a market crash affecting equities, property market reversals and future changes in interest rates.
- the timing of the investment.
For example, a younger person should not tie up all money in a pension fund if some of the money will be needed in the near future, as the pension cannot be accessed until the individual is 55.

15 Investments

Investment to generate income

An individual with low income will require investments that generate income. This will be the case for many pensioners.

The main examples of investments generating income are:

Investment	Income
Bank and building society accounts	Interest
Gilts	Interest
Corporate bonds	Interest
Government stock	Interest
Shares/unit trusts, investment trusts	Dividends
Investment property	Rent

Investment to generate capital growth

Some investments are more suitable when considering capital growth.

These may include:

- Unit trusts, investment trusts and shares where the profits are retained to generate growth instead of being distributed.
- Investment property.
- Capital bonds.

Choosing the investment

Some types of investment appear under both headings above, for example property. Many people invest in property for capital growth. However, some income is needed to cover the outgoings such as interest on borrowings and the cost of utilities.

For individuals who do not feel confident in their ability to choose the right properties to purchase, or who may wish to invest in a larger development the introduction of the real estate investment trust (REIT) allows them to buy into property with whatever resources they have available.

Equities (i.e. shares) can be viewed as an income source or a capital investment. Companies will operate different dividend policies and the investor will need to consider these when deciding which shares to acquire.

There are some investment products that attract special tax relief. For example, up to £20,000 may be invested each year in an individual savings account (ISA). Income and gains are then exempt.

Some shares in enterprise investment schemes (EIS), seed enterprise investment scheme (SEIS) and venture capital trusts (VCT) are exempt from CGT on disposal.

Not everyone will feel able to assess which investments are most suitable. In this case, individuals may invest through a stockbroker or investment trust, relying on the fund manager to decide which investments should be made.

Many funds specialise in certain areas allowing the investor some element of choice. For example, specialising in property companies, overseas companies or technology companies.

Although the stockbroker or fund manager will charge a fee for the services, the investor is being given the benefit of the stockbroker's investment expertise.

Tax efficient investments

As we have seen, there are a number of investments that give tax advantages.

The main ones to consider are:

- Personal pension contributions – Chapter 19
- EIS and SEIS
- VCTs

Note however that although both EIS/SEIS and VCT investments produce a reduction in an individual's income tax charge for the year of investment, they are both considered to be a relatively high-risk investment.

There are other issues that need to be considered:

- An EIS or SEIS company will not normally pay a dividend. The profits are usually rolled up to give capital growth, on the assumption that the disposal of the shares will be exempt from CGT.
- EIS and SEIS companies are unquoted. It may be difficult to withdraw the investment as there is no ready market for the shares.
- These companies tend to be start-up companies, which is a particularly risky area for investors who cannot afford to lose their investment.
- To retain the income tax relief and obtain the CGT exemptions available the shares have to be retained for a minimum of three years (EIS and SEIS) and five years (VCT).

Key Investment products

	IT free	CGT free	Risk	Liquidity	Income/capital growth
Bank/B Soc accounts	x	N/A	L	L1	I
NS&I accounts:					
– Investment	x	N/A	RF	L1	I
– Direct Saver	x	N/A	RF	L1	I
NS&I savings certificates	✓	✓	RF	L2	I
Premium bonds	✓	✓	RF	L1	I
Qualifying life assurance policies	✓	✓	L	L3	C
EIS/SEIS (Note 1)	✓	✓	VH	L3	C
VCT scheme	✓	✓	H	L1	C
Pension schemes (Note 2)	✓	✓	M	L3	C
Qualifying corporate bonds	x	✓	M	L1	C/I
Gilts	x	✓	L	L1	I
'Real' property	x	x	M	L3	C/I
REIT	x	x	M	L1	C/I
Investment trusts, unit trusts	x	x	M	L1	C
Quoted shares/securities	x	x	M/H	L1	C/I
Unquoted shares/securities	x	x	VH	L3	C/I
ISAs	✓	✓	L/M	L1	C/I

Key to terms:

I	Income	H	High risk
C	Capital growth	VH	Very high risk
x	Chargeable	L1	Immediate access
✓	Tax-free	L2	Access possible but penalty
RF	Risk-free	L3	Non-liquid
L	Low risk		
M	Medium risk	N/A	Not applicable

Notes:

- (1) Tax relief on investment but income taxable
- (2) Tax relief on payments

For ATX you should assume the levels of risk noted above, though these may change in reality.

16 Raising finance for the individual

There are a number of different ways to raise finance as an individual borrower. A reminder of the key methods is given below.



Raising finance

Mortgages (long-term source of finance)

Mortgages are a good source of finance when interest rates are low.

If it is thought that the rates may rise it is possible to obtain a fixed rate mortgage, which provides certainty about the cost of the mortgage over the period for which the rate is fixed.

A fixed rate mortgage may at times be more expensive than an ordinary mortgage, however this may be preferable to obtain certainty of cash outflows.

Moving between providers can be expensive as lenders will often charge an early redemption penalty if the mortgage is repaid.

If property prices increase it may be possible to increase the mortgage on the property to use the funds for other purposes, such as starting a new business, buying property to let or to use as a holiday home.

Credit cards

Credit cards are an expensive source of finance, as the interest rates charged are very high. They should really only be considered for short term finance.

Many cards offer interest free periods on balance transfers and these can be used to minimise the cost of interest.

Bank overdraft (short to medium source of finance)

The interest rate on an overdraft tends to be lower than on a credit card, so this could be a better way to borrow for short or medium term.

Hire purchase agreements (short to medium source of finance)

This is often used as a method of purchasing household goods. Interest rates tend to be variable, and can be expensive.

17 Calculating the net return on an investment

It is difficult to compare the overall returns on different investments if they produce income and capital growth, as one may balance off against the other.

Where individuals need an amount of income to meet their living expenses it is slightly easier to compare the investment return, as the net of tax return can be calculated for both a basic rate and higher rate taxpayer.

It is more difficult to predict capital growth for the different types of investments.

Elderly taxpayers may prefer a higher rate of income and lower long-term capital growth, as they have no realistic need for the value of their investments to increase during their remaining lifetime.



Illustration 5 – Net return

Tim has a bank overdraft of £2,000 and pays interest at 9% but has £5,000 in a deposit account earning interest at 4.7% gross.

Discuss the financial planning implications and suggest how Tim could increase his disposable income. Assume Tim is a basic rate tax payer and has taxable non-savings income in excess of £5,000.

Solution

- Tim is paying bank interest of £180 ($9\% \times £2,000$).
- Tim is receiving bank interest of £235 ($4.7\% \times £5,000$) which is tax-free, as he is a basic rate tax payer and therefore entitled to a savings income nil rate band (SNRB) of £1,000.
- His net disposable income is £55 ($£235 - £180$).
- Tim should use £2,000 of the capital from his deposit account to repay his bank overdraft, thus saving him £180 of interest.
- Tim should, as far as is practical in accordance with living costs, build up his savings to fully utilise his SNIIRB of £1,000 (£500 if he becomes a higher rate taxpayer). If his savings income exceeds the available NRB in the future, sufficient capital should be transferred to a cash ISA to ensure that income in excess of the SNIIRB is received tax-free. This assumes he can get the same rate of interest on savings in an ISA.
- Interest received at ($4.7\% \times £3,000$) = £141.
- Tim has increased his disposal income by £86 ($£141 - £55$).



Illustration 6 – Net return

Wout has inherited £50,000 from his grandmother.

He has not yet decided what he should do with this money. He is currently in full time employment, and is a higher rate taxpayer.

He is considering investing in either shares or property, as he feels this would produce both income and capital growth.

As part of his considerations he has obtained the following information:

- (1) If he bought shares in X plc there would be an annual dividend payment of £900 (approx.).
- (2) Shares in Y plc could be bought. Y plc is a REIT, and it is anticipated that the return would be in the region of £1,743 per annum.
- (3) He could buy a small property and let it to students. The rental would be £150 per week with estimated outgoings of £80 per week.
- (4) His bank is offering an internet deposit account paying gross interest of 5%.

Discuss the financial planning implications and consider the ways in which Wout's inheritance money could be invested.

Solution

X plc shares Income tax treatment:

The dividends will be received tax-free as they will be covered by the dividend nil rate (DNRB) of £1,000. The DNRB is available irrespective of taxpayer's taxable income.

Capital growth

- possible over a period
- subject to fluctuations of the stock market

Easily realisable – yes

- quoted shares can be sold on the stock exchange

Risk – stock market crash

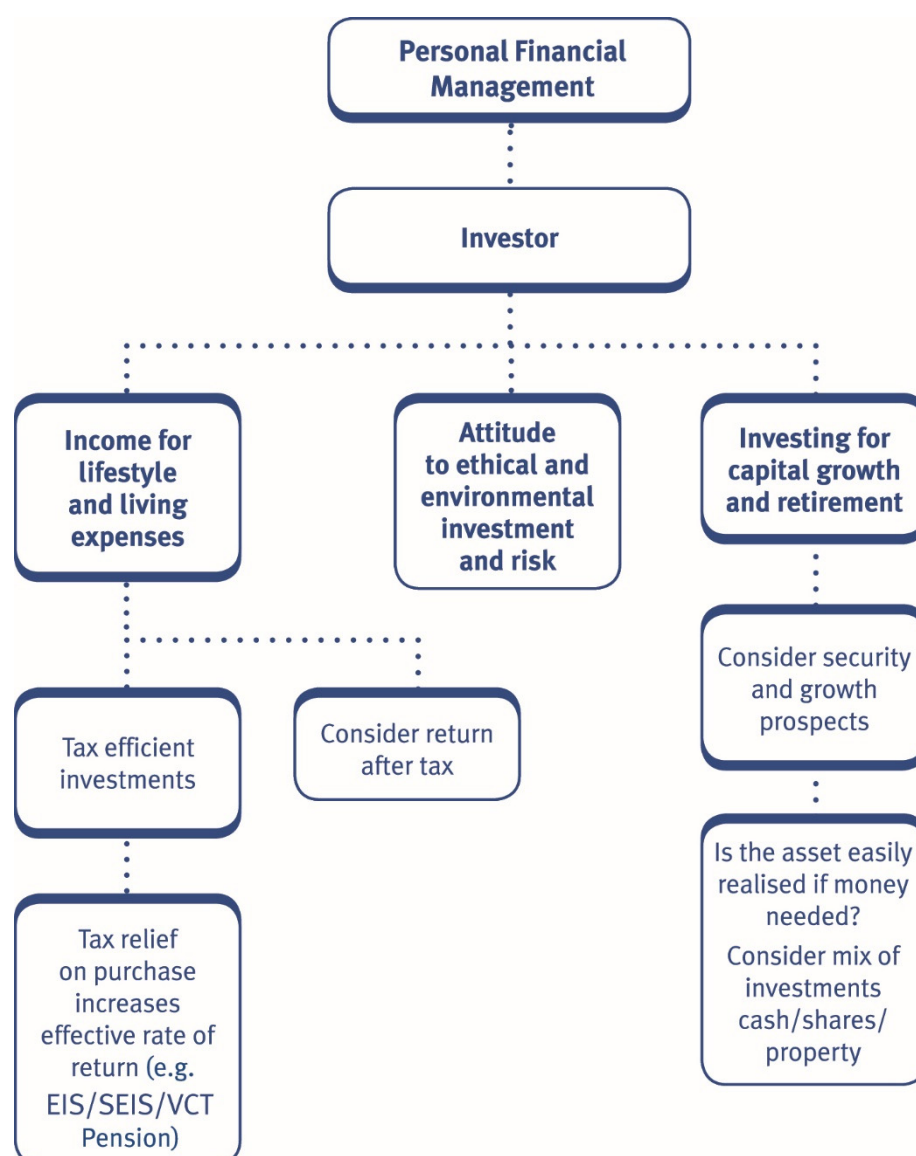
Y plc shares	Net return after tax:	£
	Income ($£1,743 \times 100/80$)	2,179
		<hr/>
	Income tax at 40%	872
	Less: Tax credit ($20\% \times £2,179$)	(436)
		<hr/>
	Income tax payable	436
		<hr/>
	Net return ($£1,743 - £436$) (Note)	1,307
		<hr/>
	Capital growth – possible over a period of time	
	Easily realisable – yes – quoted shares	
	Risk – property value crash	

Note: Alternative calculation using effective rate of tax on net income received by a HR taxpayer:

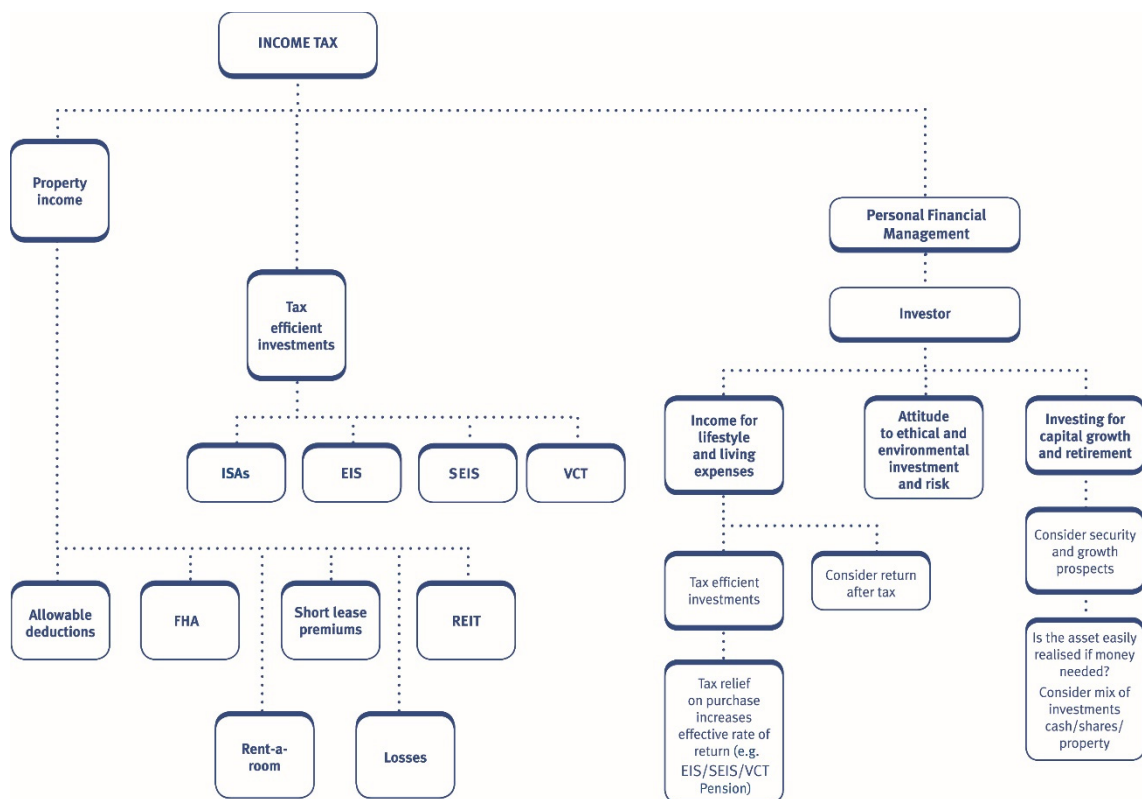
(Net interest $\times 25\%$) = ($£1,743 \times 25\%$) = £436 Net return = ($£1,743 \times 75\%$) = £1,307

Property	Net return after tax:	£
	Rent received ($52 \times £150$)	7,800
	Less: Costs ($52 \times £80$)	(4,160)
		<hr/>
	Net rental income	3,640
	Less: Tax at 40%	(1,456)
		<hr/>
	Net return	2,184
		<hr/>
	Capital growth – possible depending on area and market	
	Easily realisable – no – dependent on property market, time to find buyer, process transactions	
	Risk – rent not paid but expenses still need to be met, property value crash	

Bank	Net return after tax:	£
	Interest (£50,000 × 5%)	2,500
	Less: Tax on £500 × 0%	(0)
	£2,000 × 40%	(800)
		<hr/>
	Net return	1,700
		<hr/>
	Capital growth – none	
	Easily realisable – yes	
	Risk – reduction in interest rates	



18 Chapter summary



Test your understanding answers



Test your understanding 1

Giles

Property income – 2023/24

(a) Cash basis

	£
Rent received ($£3,600 \times 11/12$)	3,300
Expenses:	
Insurance paid 1 June 2023	(480)
Replacement freezer	(380)
	<hr/>
Property income	2,440
	<hr/>

(b) Accruals basis

	£
Rent receivable	3,600
Expenses:	
Insurance payable ($(3/12 \times £420) + (9/12 \times £480)$)	(465)
Replacement freezer	(380)
Redecoration	(750)
	<hr/>
Property income	2,005
	<hr/>

Notes

- (1) The new garage is classified as capital and is not deductible for property income purposes under either the cash or accruals basis. It will be added to the cost of the property for capital gains tax purposes when the property is sold.
- (2) Replacement furniture relief is available for the cost of the replacement freezer under both the cash and accruals basis.
- (3) Replacement furniture relief is not available for the cost of the table as it is a new item rather than a replacement.
- (4) The rent due on 6 March 2024 is not received until the tax year 2024/25. Under the cash basis, it will be taxed in the tax year in which it is received (2024/25) whereas under the accruals basis it is taxed in the tax year to which it relates (2023/24).
- (5) The redecoration carried out in March 2024 is not paid for until the tax year 2024/25. Under the cash basis, it will be deductible in the tax year in which it is paid (2024/25) whereas under the accruals basis it is deductible in the tax year to which it relates (2023/24).



Test your understanding 2

Rodney

21-year lease:	£	£
Premium	10,500	
Less: $£10,500 \times 2\% \times (21 - 1)$	(4,200)	
	<hr/>	6,300
14-year lease:		
Premium	30,000	
Less: $£30,000 \times 2\% \times (14 - 1)$	(7,800)	
	<hr/>	22,200
Property income		<hr/> 28,500
Alternative calculation		
		£
21-year lease:		
$[(51 - 21)/50] \times £10,500$		6,300
14-year lease:		
$[(51 - 14)/50] \times £30,000$		22,200
Property income		<hr/> 28,500



Test your understanding 3

Jian

(i) House 1

It is likely that House 1 will be regarded as a furnished holiday accommodation (FHA) as it meets the following conditions:

- Situated in the UK or EEA, furnished and let on a commercial basis
- Available for letting to the public for not less than 210 days in the tax year 2023/24
- Actually let at least 105 days in that 210-day period
- It is not clear how long each person occupied the house for. However, in the tax year 2023/24, assuming there were no single lettings of > 31 days, and the house will be a FHA.

Advantages of the house being FHA

- A full deduction will be available for plant and machinery, such as furniture and kitchen equipment. This will be more beneficial than replacement furniture relief.
- The FHA income will qualify as earnings for pension purposes.
- On disposal, the house will qualify for business asset disposal relief, rollover relief or gift holdover relief if the conditions for the reliefs are met.

(ii) UK property income/loss – 2023/24

FHA		£
Rent received (House 1) (16 × £200)		3,200
Less: Allowable expenses		
Council tax (£730 × 42/52) (Note 1)		(590)
Insurance (£310 × 42/52)		(250)
Advertising		(545)
Cost of furniture (£5,200 × 42/52)		(4,200)
		<hr/>
FHA loss (Note 2)		(2,385)
		<hr/>
Other property income		£
Rent received (House 2) (£8,600 × 3/12)		2,150
Lease premium (W)		3,760
Less: Allowable expenses		
Repairs		(7,465)
		<hr/>
		(1,555)
		<hr/>
Rent from furnished room	7,850	
Less: Rent-a-room relief	(7,500)	
	<hr/>	350
		<hr/>
Property loss (Note 3)		(1,205)
		<hr/>

Working: Lease premium

$$£4,000 \times [(51 - 4)/50] = £3,760$$

Notes:

- (1) Running expenses other than advertising must be time apportioned to reflect the period of time the property was available for letting. This also applies to the cost of furniture so that only the business use element is deductible.
- (2) The loss incurred in letting the FHA must be carried forward and offset against the first available future UK FHA income.
- (3) The net loss incurred in letting House 2 and the furnished room in Jian's main residence must be carried forward and offset against the first available future property income.


Test your understanding 4
Talia

Talia can reduce her income tax in the tax year in which she buys the EIS shares by 30% of the amount invested.

	£
Income tax liability	14,000
Less: EIS relief (30% × £30,000)	(9,000)
	5,000


Test your understanding 5
Precious
(a) Amount of reinvestment relief

Precious can claim relief for any amount up to £150,000.

However, to claim this full amount will mean that she does not make full use of her AEA for the tax year 2023/24.

The EIS relief claim should therefore be calculated as follows:

	£	
Capital gain	150,000	
Less: EIS Reinvestment relief	(132,000)	Balancing figure
	18,000	
Chargeable gain	18,000	
Less: AEA	(6,000)	
Less: Capital loss b/f	(12,000)	
	0	
Taxable gain	0	

(b) Sale of EIS shares

When Precious disposes of the EIS shares in the tax year 2026/27, the gain of £132,000 will become chargeable.

The gain on the EIS shares of £175,000 will be exempt from CGT as the shares have been held for at least three years.

**Test your understanding 6****Christine**

The shares qualify for BADR as Christine has had $\geq 5\%$ interest in the company (a trading company) for more than two years and works for the company.

However, Christine does not have to claim BADR and can defer the gain with an EIS claim as follows:

Christine

	£	
Capital gain	250,000	
Less: EIS Reinvestment relief	(188,000)	Balancing figure
	<hr/>	
Chargeable gain	62,000	
Less: AEA	(6,000)	
Less: Capital loss b/f	(56,000)	
	<hr/>	
Taxable gain	0	
	<hr/>	

The deferred gain of £188,000 will become chargeable in the future (e.g. when the EIS shares are disposed of) and will be taxed at 10% as the gain would have qualified for BADR if crystallised in the tax year 2023/24.

If the EIS shares are held for three years, any rise in value of the EIS shares will be exempt, any losses are always allowable.

Alternatively, Christine could choose not to claim EIS relief and claim BADR in the tax year 2023/24 instead as follows:

	£
Gain qualifying for BADR	250,000
Less: AEA	(6,000)
Less: Capital loss b/f	(56,000)
	<hr/>
Taxable gain	188,000
	<hr/>
Capital gains tax @ 10%	18,800
	<hr/>

The decision made by Christine will depend on her cash flow position in the tax year 2023/24, although there is no advantage to be gained from claiming BADR and paying tax in the tax year 2023/24.



Test your understanding 7

Imran

Imran can reduce his income tax for the tax year 2023/24 by 50% of the amount invested in SEIS shares.

	£
Income tax liability	37,000
Less: SEIS relief (50% × £60,000)	(30,000)
	<hr/>
	7,000
	<hr/>



Test your understanding 8

Zosia

(a) Taxable gains – 2023/24

	(i)	(ii)
SEIS shares cost	£60,000	£125,000
	<hr/>	<hr/>
	£	£
Capital gain	75,000	75,000
Less: SEIS reinvestment relief (W)	(30,000)	(37,500)
	<hr/>	<hr/>
Chargeable gain	45,000	37,500
Less: AEA	(6,000)	(6,000)
Less: Capital loss b/f	(22,000)	(22,000)
	<hr/>	<hr/>
Taxable gain	17,000	9,500
	<hr/>	<hr/>

Working: SEIS reinvestment relief

	(i)	(ii)
	£	£
Maximum exemption		
= 50% × lower of		
(i) Gain	75,000	75,000
(ii) Amount invested in SEIS qualifying for IT relief	60,000	100,000
		(max)
CGT exemption	30,000	37,500

Note: In scenario (ii), if Zosia's capital loss was more than £31,500 (£37,500 – £6,000), Zosia could claim up to £37,500 exemption but could choose instead to restrict the claim to preserve the use of the capital loss b/f and the AEA.

(b) **Sale of SEIS shares**

When Zosia sells the SEIS shares in 2028, there will be no gain.

The gain that was subject to reinvestment relief will not become chargeable, as the SEIS relief is an exemption rather than a deferral.

The gain on the SEIS shares will be exempt from CGT as the shares have been held for more than three years.



Test your understanding 9

Zosia

As the shares have been sold within three years, both income tax relief and capital gains tax relief will be withdrawn in both situations.

(a) **Sale to sister – not in an arm's length transaction**

Original investment	£60,000	£125,000
All IT relief claimed = withdrawn	£30,000	£50,000
All CGT exemption claimed = withdrawn	£30,000	£37,500

(b) **Sale to friend – in an arm's length transaction**

Original investment	£60,000	£125,000
IT relief claimed	£30,000	£50,000
CGT exemption claimed	£30,000	£37,500
IT relief withdrawn = Lower of:		
(i) IT relief given	£30,000	£50,000
(ii) (50% × SP received for shares) = (50% × £65,000)	£32,500	£32,500
CGT relief withdrawn = (% of IT relief withdrawn × gain exempt)	100%	£32,500 <hr/> £50,000 = 65% (65% × £37,500) = £24,375
	£30,000	



Test your understanding 10

Matthew

Income tax computation – 2023/24

	£
Trading income	90,000
Bank interest	458
Income from REIT ($£4,992 \times 100/80$)	6,240
Discretionary trust income ($£3,300 \times 100/55$)	6,000
IIP trust income ($£2,205 \times 100/91.25$) (dividends)	2,416
VCT dividends – exempt	0
	<hr/>
Total income = Net income	105,114
Less: PA (W1)	(12,570)
	<hr/>
Taxable income	92,544
	<hr/>

Analysis of income

Dividends	Savings	Non-savings income
£2,416	£458	($£92,544 - £458 - £2,416$) = £89,670

Income tax:

	£		£
Non-savings – basic rate (W2)	54,275	$\times 20\%$	10,855
Non-savings – higher rate	35,395	$\times 40\%$	14,158
	<hr/>		
	89,670		
Savings income – SNRB	458	$\times 0\%$	0
Dividend income – DNRB	1,000	$\times 0\%$	0
Dividend income – higher rate	1,416	$\times 33.75\%$	478
	<hr/>		<hr/>
	92,544		25,491
	<hr/>		
Less: EIS relief ($£50,000 \times 30\%$)			(15,000)
			<hr/>
Income tax liability			10,491
			<hr/>

Workings**(W1) Personal allowance**

As Matthew's net income is greater than £100,000, his personal allowance may be reduced.

However, the net income is reduced by the gross pension contribution of £16,575 ($£13,260 \times 100/80$) to give adjusted net income of £88,539 ($£105,114 - £16,575$).

Therefore, the full PA is available.

(W2) Extended basic rate band

Matthew's basic rate band is extended by the gross pension contribution of £16,575.

Extended basic rate band = £54,275 ($£37,700 + £16,575$).

Pensions

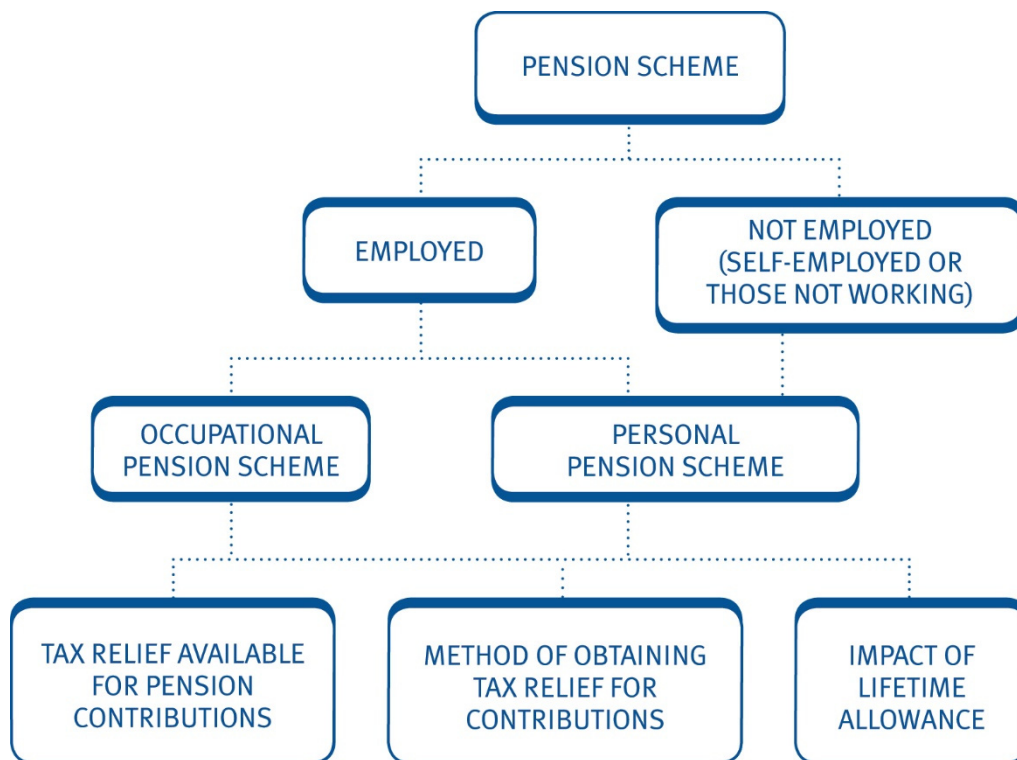
Chapter learning objectives

Upon completion of this chapter you will be able to:

- explain the basis for calculating the maximum annual contributions to a pension scheme for an individual
- calculate the tax relief available for pension contributions
- explain the concept of the lifetime allowance and the implications of the allowance being exceeded
- understand the threshold level of income below which tapering of the pensions annual allowance does not apply.



One of the PER performance objectives (PO17) is to review and advise on any potential tax risks for an individual and/or tax minimisation measures. This would include advising on pension contributions. Working through this chapter should help you understand how to demonstrate that objective.



Introduction



This chapter is a revision of the tax consequences of investing in a pension scheme covered in TX.

A brief reminder of TX content is given in supplementary reading and revision examples are provided to check your retention of the required TX knowledge.

The main new topics introduced are the spreading of employer contributions, prohibited assets and benefits received on retirement and on death.

1 Pension schemes

Individuals can set up an investment of funds to provide an income during their retirement in a tax efficient way by making payments into a pension scheme.

A pension scheme is a savings plan for retirement that enjoys special tax privileges, but only if the scheme is registered with HMRC.

You are not required to know the conditions for a scheme to be classed as 'registered' so the term 'registered' will not be used in the exam.

Investing in a pension scheme is a long-term investment and is very tax efficient for the following reasons:

- The individual obtains tax relief on the contributions made into the scheme.
- Where an employer contributes into the scheme, tax relief for the employer contributions is available with no taxable benefit for the employee.
- Pension scheme funds can grow tax-free as the scheme is exempt from income tax and capital gains tax.
- On retirement, part of the funds can be withdrawn as a tax-free lump sum.

Types of pension schemes

The two main types of pension scheme available are:

- occupational pension schemes – applicable to employees only
- personal pension schemes – applicable to all individuals.

There is a legal duty for employers to provide an occupational pension scheme to the majority of employees under automatic enrolment. There are minimum contributions required for both the employer and employee, although the employee can choose to opt out of the scheme.

A reminder of the types of pension schemes is given below and is summarised in the diagram in section 3.



Occupational pension schemes

An occupational pension scheme is a scheme set up by an employer for the benefit of its employees.

An employer may use an insurance company to provide a pension scheme for its employees, or it may set up its own self-administered pension fund.

Employees may:

- be automatically enrolled depending on the size of the employer
- choose not to join the employer's scheme and set up a personal pension plan, or
- contribute into both the employer's occupational scheme and set up a personal pension scheme.

Contributions into occupational schemes may be made by the employer, and the employee.

Occupational pension schemes may be 'defined benefit' or 'money purchase' schemes.

Under a defined benefit scheme the benefits obtained on retirement are linked to the level of earnings of the employee.

Under a money purchase scheme (also known as 'defined contribution' scheme) the benefits obtained depend upon the performance of the investments held by the pension fund.



Personal pension schemes

Personal pension schemes can be established by **any** individual including those not working (including children).

Contributions into personal pension schemes may be made by:

- the individual, and
- any third party on behalf of the individual e.g. the employer, a spouse, parent or grandparents.

Personal pension schemes are usually 'money purchase' schemes administered by financial institutions on behalf of the individual.

Overview of the tax relief rules for pension schemes

- The **amount** of tax relief available for pension contributions is the same regardless of whether the scheme is an occupational or personal pension scheme.
- The **method** of obtaining tax relief for the contributions is different depending on the scheme.
- Once the funds are invested in the scheme, **all** pension schemes are governed by the same rules.

2 Tax relief for pension contributions

A reminder of the maximum annual contributions eligible for tax relief is given below and is summarised in the diagram in section 3.



Relief for contributions made by individuals

Tax relief is available for pension contributions if the individual is resident in the UK and aged under 75.

Regardless of the level of earnings, an individual may make pension contributions of **any amount** into:

- a pension scheme, or
- a number of different pension schemes.

However, tax relief is only available for a **maximum annual amount** each tax year.

The total maximum annual gross contribution for which an individual can obtain tax relief is the **higher** of

- £3,600, and
- 100% of the individual's 'relevant earnings', chargeable to income tax in the tax year.

Relevant earnings includes trading profits, employment income, and furnished holiday accommodation income but not investment income.

Note that:

- The maximum limit applies to the total gross contributions made into all schemes where:
 - An employee contributes to both an occupational and a personal pension scheme, or
 - An individual contributes into more than one personal pension scheme.
- An individual with no relevant earnings can obtain tax relief on gross contributions of up to £3,600 p.a.

3 The method of obtaining tax relief for pension contributions

The method of obtaining tax relief for pension contributions is different depending on the type of pension scheme.

A reminder of the method of obtaining relief for pension contributions is given below and is summarised in the diagram at the end of this section.



Relief for contributions made by an individual

Personal pension contributions

The method of obtaining tax relief for contributions into a personal pension scheme (PPCs) is the same whether they are made by an employee, a self-employed individual or an individual who is not working.

Relief is given as follows:

- For a basic rate taxpayer, basic rate tax relief is automatically given by deduction at source when contributions are paid, as payments are made to the pension fund net of 20% tax. The payment is ignored in the IT computation.

- For higher rate and additional rate taxpayers, 40% or 45% tax relief is given as follows:
 - 20% at source.
 - 20% or 25% through the income tax computation, obtained by extending the basic rate band and higher rate limit by the gross payment (so that more income is taxed at 20% and less at 40% or 45%).

Note: As we saw in Chapter 16 the PA is restricted for higher earners. This means those individuals who have adjusted net income (ANI) > £100,000. In calculating ANI the gross amount of any personal pension contributions must be deducted.

Occupational pension scheme contributions

Where employees make pension contributions into an occupational pension scheme:

- payments are made gross, and
- tax relief is given through the PAYE system by reducing the earnings subject to tax (i.e. the payment is an allowable deduction from employment income).



Test your understanding 1

The following individuals made gross pension contributions into a personal pension scheme in the tax year 2023/24 and had the following trading profits:

	Pension contributions (gross)	Trading profits
	£	£
Esma	25,000	20,000
Dante	40,000	100,000

Explain how tax relief for the pension contributions will be given in the tax year 2023/24 for each individual and calculate the income tax liability of Dante for 2023/24.



Test your understanding 2

Yoana is employed by Lloyd Ltd on a salary of £80,000 p.a. She is a member of the company's occupational pension scheme.

Yoana pays 3% of her salary into the scheme each year and Lloyd Ltd matches this contribution. Yoana has no other income.

Calculate Yoana's income tax liability for the tax year 2023/24, showing how tax relief is obtained for her pension contributions.



Relief for contributions by employers

Contributions paid by an employer into a pension scheme are:

- tax deductible in calculating the employer's taxable trading profits, provided the contributions are paid for the purposes of the trade, and
- an exempt employment benefit for the employee, and
- added to the pension contributions paid by the employee on which tax relief is given to determine whether the annual allowance has been exceeded and an income tax charge levied.

The deduction against the employer's trading profits is given in the accounting period in which the contribution is **paid**; the accounting treatment is not followed.



Illustration 1 – Relief for contributions

Hugh is a self-employed builder who prepares accounts to 31 March each year. His recent tax adjusted trading profits have been:

Year ended 31 March 2023	£80,000
Year ended 31 March 2024	£90,000

Hugh's wife, Holly, has employment income from a part-time job of £13,500 p.a. and property income of £20,000 p.a. (the property is let on a long term basis to a tenant).

They also have a joint bank account on which they earned interest of £5,000 in the tax year 2023/24.

During the year to 5 April 2024, Hugh paid £19,400 into his personal pension scheme. Holly paid £2,600 into her employer's occupational pension scheme and Holly's employer contributed a further £2,000.

Calculate how much of the pension contributions made by Hugh, Holly and Holly's employer in the tax year 2023/24 will obtain tax relief and explain how the tax relief will be obtained.

Solution

Hugh

- Hugh can obtain tax relief for a pension contribution of up to a maximum of 100% of his earnings in the tax year 2023/24.
- His earnings are his taxable trading profits for the tax year 2023/24 = £90,000 (year ended 31 March 2024).
- Investment income such as bank interest is not included.
- Hugh will have paid the pension contribution net of basic rate tax of £4,850 ($£19,400 \times 20/80$).

- The gross pension contribution is £24,250 ($£19,400 \times 100/80$).
- Higher rate tax relief is obtained by extending the basic rate band by £24,250 from £37,700 to £61,950.

Holly

- Holly can obtain tax relief for a gross pension contribution of up to a maximum of the higher of £3,600 or 100% of her employment earnings in the tax year 2023/24 (i.e. £13,500).
- Her gross pension contribution of £2,600 is less than £13,500, therefore she can obtain tax relief for all £2,600 contributions paid.
- Holly's employer will deduct the gross contribution of £2,600 from her employment income before calculating her income tax liability under PAYE.
- Holly's employer's contribution of £2,000 is an exempt benefit.

Holly's employer

- Holly's employer will obtain tax relief for all of the £2,000 contribution made into the occupational pension scheme.
- Relief is given as an allowable deduction in the calculation of the employer's taxable trading profits.

Contributions in excess of annual allowance

There is no limit on the amount of contributions that may be made into pension schemes by an individual, the individual's employer or any other party.

However, tax relief for pension contributions made by an individual is restricted to the maximum annual amount.

A tax charge is levied on the individual if the total of all gross contributions (by the individual, the employer and third parties) on which relief has been obtained exceeds the **annual allowance** (AA) of £40,000.

This can be increased by **bringing forward** any unused annual allowances from the **previous three tax years**.

The AA for the tax years 2020/21 to 2022/23 was also £40,000.

- An unused amount can only be carried forward if the individual was a member of a pension scheme for that tax year, otherwise it is lost.
- The AA for the **current year is used first**, then the unused AA from earlier years **starting with the earliest tax year** (i.e. on a FIFO basis).



- The AA figure is given in the tax tables provided in the examination.



Test your understanding 3

Damjan and Hasan made gross personal pension contributions as follows:

	Damjan	Hasan
	£	£
2020/21	52,000	0
2021/22	35,000	5,000
2022/23	17,000	6,000

Damjan has been a member of a pension scheme since the tax year 2012/13. Hasan joined a pension scheme in the tax year 2021/22. Both have relevant earnings of £110,000 per annum.

State the maximum gross contribution that Damjan and Hasan could make in the tax year 2023/24 without incurring an annual allowance charge.



Test your understanding 4

Ahmed made the following gross contributions to his personal pension:

	£
2020/21	12,000
2021/22	36,000
2022/23	33,000
2023/24	58,000

He has relevant earnings of £150,000 each year.

State the amount of unused allowances to carry forward to the tax year 2024/25.

Calculation of annual allowance charge

Where the total of all contributions on which relief has been obtained exceeds the AA (including brought forward annual allowances) there is a tax charge on the excess.

The tax charge is calculated as if the excess is the individual's top slice of income (i.e. taxed last after all sources of income, including dividends) but is taxed at non-savings income rates. The income does not count towards adjusted net income.

The excess is therefore taxed at 20/40/45% and added to the individual's total tax liability, and is either paid through the self-assessment system or, in some cases, may be taken from the individual's pension fund.



Test your understanding 5

Marcus has been employed for many years and set up his personal pension scheme ten years ago.

In the tax year 2023/24 Marcus earned £110,000 and made a gross contribution of £50,000 into his personal pension scheme.

Marcus has regularly contributed £50,000 (gross) to his pension since the tax year 2010/11.

His employer contributed a further £30,000 into his personal pension scheme in the tax year 2023/24.

Calculate Marcus' income tax liability for the tax year 2023/24.

Restriction of annual allowance – high income individuals

- The annual allowance is gradually reduced for individuals with high income.
- The restriction applies to individuals with a 'threshold income' exceeding £200,000 and 'adjusted income' exceeding £240,000.
- The annual allowance is reduced by:
 $(\text{Adjusted income} - £240,000) \times 50\%$.
- If necessary, the reduction is rounded down to the nearest pound (although in the examination rounding up or down is acceptable).
- The maximum reduction to the annual allowance is £36,000, which means that the minimum annual allowance an individual will be entitled to is £4,000.

Note that the definitions of the key terms 'threshold income' and 'adjusted income' are complicated in practice, but for ATX purposes can be simplified as shown below.

Approach to questions

- Calculate 'threshold income' as follows:

	£
Net income (from the income tax computation)	X
Less: Individual's gross personal pension contributions	(X)
	<hr/>
Threshold income	X
	<hr/>

- If threshold income exceeds £200,000, calculate the individual's adjusted income as follows:

	£
Net income (from the income tax computation)	X
Plus: Individual employee's occupational pension contributions	X
Employer's contributions into any scheme for that individual	X
	<hr/>
Adjusted income	X
	<hr/>

If threshold income ≤ £200,000	The annual allowance for the tax year is £40,000 (no restriction)
If threshold income > £200,000 and adjusted income ≤ £240,000	
If threshold income is > £200,000 and adjusted income > £240,000	The annual allowance for the tax year must be reduced by (adjusted income – £240,000) × 50%

- Note that if the individual's adjusted income is £312,000 or more and a restriction is necessary, the annual allowance will be reduced to the minimum of £4,000.

Note that the term 'adjusted income' for pension purposes is not the same as 'adjusted net income' for the purposes of restricting the personal allowance. For the 'adjusted income' figure, there is no deduction for gross gift aid donations nor the individual's gross personal pension contributions, and the employer's pension contributions need to be added to net income.

However, as the adjustments to net income to calculate adjusted income all relate to employment, for the purposes of the ATX exam, adjusted income for self-employed individuals will be the same as net income.



Test your understanding 6

The following are details of pension contributions made by, and on behalf of, four individuals during the tax year 2023/24:

	Gross contributions made by the individual		Employer's contributions	Net income
	Occupational pension	Personal pension		
	£	£	£	£
Ann	11,000	23,000	20,000	190,000
Belinda	0	2,000	0	215,000
Carol	12,000	0	20,000	250,000
David	20,000	0	28,000	270,000

Calculate the annual allowance for the tax year 2023/24 for each individual assuming they have no unused allowances brought forward.

Planning with pension contributions

Spouses and civil partners should both be looking to make pension contributions. If the contributions are not to be made equally, the higher rate taxpayer should make the contributions.

Note that pension contributions made by a higher rate taxpayer with dividend income may achieve a saving in excess of 40%, as they receive higher rate relief for the contributions and, due to the extension of the basic rate band, dividends could fall into the basic rate band and achieve further tax savings.

Also, a taxpayer with income in excess of £100,000 may consider making pension contributions to avoid the reduction of the personal allowance.



Illustration 2 – Pension contributions

Martina is self-employed and made profits of £42,000 in the year ended 31 March 2024.

Her only other income is dividends received of £12,000.

Calculate the tax saving that will be achieved if Martina pays £1,600 into her personal pension in the tax year 2023/24.

Solution

	£
Trading income	42,000
Dividend income	12,000
	<hr/>
Total income	54,000
Less: Personal allowance	(12,570)
	<hr/>
Taxable income	41,430
	<hr/>

Analysis of income

Dividends	Non-savings income
£12,000	£29,430 (£41,430 – £12,000)

Income tax – with no pension contributions

	£		£
Non-savings – basic rate	29,430	× 20%	5,886
Dividend income – DNRB	1,000	× 0%	0
Dividend income – basic rate	7,270	× 8.75%	636
	<hr/>		
	37,700		
Dividend income – higher rate	3,730	× 33.75%	1,259
	<hr/>		
	41,430		
	<hr/>		
Income tax liability			<hr/> 7,781 <hr/>

Income tax – with pension contributions

Gross pension contribution = $(£1,600 \times 100/80) = £2,000$ Higher rate threshold = $(£37,700 + £2,000) = £39,700$.

	£		£
Non-savings – basic rate	29,430	× 20%	5,886
Dividend income – DNRB	1,000	× 0%	0
Dividend income – basic rate	9,270	× 8.75%	811
	<hr/>		
	39,700		
Dividend income – higher rate	1,730	× 33.75%	584
	<hr/>		
	41,430		
	<hr/>		
Income tax liability			<hr/> 7,281 <hr/>

Tax saving

	£
Tax saved in computation ($£7,781 - £7,281$)	500
Tax saved at source ($£2,000 - £1,600$)	400
	<hr/>
	900
	<hr/>

Alternative calculation

The tax saving can be calculated very quickly without doing full income tax computations, simply by using Martina's marginal rates of tax.

The extension of the basic rate band will mean that dividends previously taxed at 33.75% will now be taxed at just 8.75%, as follows:

	£
Tax saved by gross pension contribution	
At source (payment made net of 20% tax) ($20\% \times £2,000$)	400
By extension of basic rate band ($33.75\% - 8.75\%$) $\times £2,000$	500
	<hr/>
	900
	<hr/>

Where possible, you should always try to calculate tax savings using marginal rates in the exam.

**Test your understanding 7**

Emily has an annual salary of £130,000, and is considering making a contribution to her personal pension to avoid losing her personal allowance.

Calculate the tax saving that will be achieved if Emily pays £24,000 cash into her personal pension in the tax year 2023/24.

**Spreading of employer contributions**

Where there is an increase in the level of employer contributions from one period to the next of over 210%, HMRC requires the tax relief to be spread evenly over a number of years.

**Spreading provisions**

The first 110% is relievable in the current year. The excess is dealt with as follows:

Excess (over 110% of previous year)	Tax relief obtained
Less than £500,000	All in current year
Between £500,000 and £1,000,000	Spread evenly over 2 years
Between £1,000,000 and £2,000,000	Spread evenly over 3 years
£2,000,000 or more	Spread evenly over 4 years

Additional contributions for existing pensioners are deductible when made.

4 Accessing the pension

Benefits on retirement

The funds in the pension scheme cannot be accessed by the individual until the individual reaches pension age. Each pension scheme will have its own scheme rules regarding when an individual can access the scheme funds.

However, the minimum pension age can never be below 55.

For individuals in **defined benefit schemes** (principally occupational pension schemes) the benefits on reaching pension age are **linked to the level of earnings** of the employee.

For individuals in **money purchase schemes** (principally personal pension schemes) the benefits on pension age are **dependent on the amount of funds accumulated** in the pension fund (i.e. contributions plus investment income/gains).

Individuals with money purchase schemes have complete flexibility in the way in which they can access the accumulated funds in their pension scheme when they reach pension age.

All or part of the pension fund can be taken to provide a pension at any time above this pension age.

It is therefore possible to receive a pension and still continue to work.

On reaching pension age, the individual may:

- (i) receive a tax-free lump sum payment

Maximum = 25% of the lower of

- the value of the fund
- the lifetime allowance (see below).

- (ii) withdraw the balance of the pension fund at any time.

The part of the fund not withdrawn can continue to grow in a relatively tax-free environment.

Any withdrawals from the balance of the fund are treated as taxable income and are liable to income tax at the normal rates of tax (i.e. 20%, 40% or 45%).

The part of the fund not withdrawn can continue to grow in a relatively tax-free environment.



The lifetime allowance charge

There is no restriction on the **total** contributions that an individual can make into a pension scheme. However, if the funds in the scheme exceed the lifetime allowance when a benefit is taken there will be a tax charge on the excess.

The lifetime allowance for the tax year 2023/24 is £1,073,100.

If the fund exceeds £1,073,100 and the excess is to be used to fund a larger level of pension income (known as annuities) the tax charge will be 25% of the excess.

Where the taxpayer chooses to take the excess in cash the tax charge will be 55% of the excess.



Illustration 3 – Lifetime allowance charge

Tai was 64 on 16 August 2023 and decided to take his pension benefits on that date. He had a money purchase pension fund which was valued at £2,700,000 on 16 August 2023.

Tai took the maximum tax-free lump sum. The balance up to the lifetime allowance was vested to provide pension income benefits.

Show the tax consequences if:

- (a) **Tai takes the excess fund as a lump sum**
- (b) **Tai takes the excess fund to buy pension income.**

Solution

Maximum tax-free lump sum (£1,073,100 × 25%)	£268,275
The balance vested to provide pension income benefits (£1,073,100 × 75%)	£804,825
(a) The excess taken as an additional lump sum	
	£
Excess (£2,700,000 – £1,073,100)	1,626,900
Less: Lifetime allowance charge (£1,626,900 × 55%)	(894,795)
Scheme administrator will pay Tai	732,105

(b) The excess taken to provide pension income

	£
Excess (£2,700,000 – £1,073,100)	1,626,900
Less: Lifetime allowance charge (£1,626,900 × 25%)	(406,725)
	<hr/>
Balance vested to provide pension income benefits	1,220,175
	<hr/>

Note: The pension income received by Tai in the future will be taxable as non-savings income.

**Benefits on death**

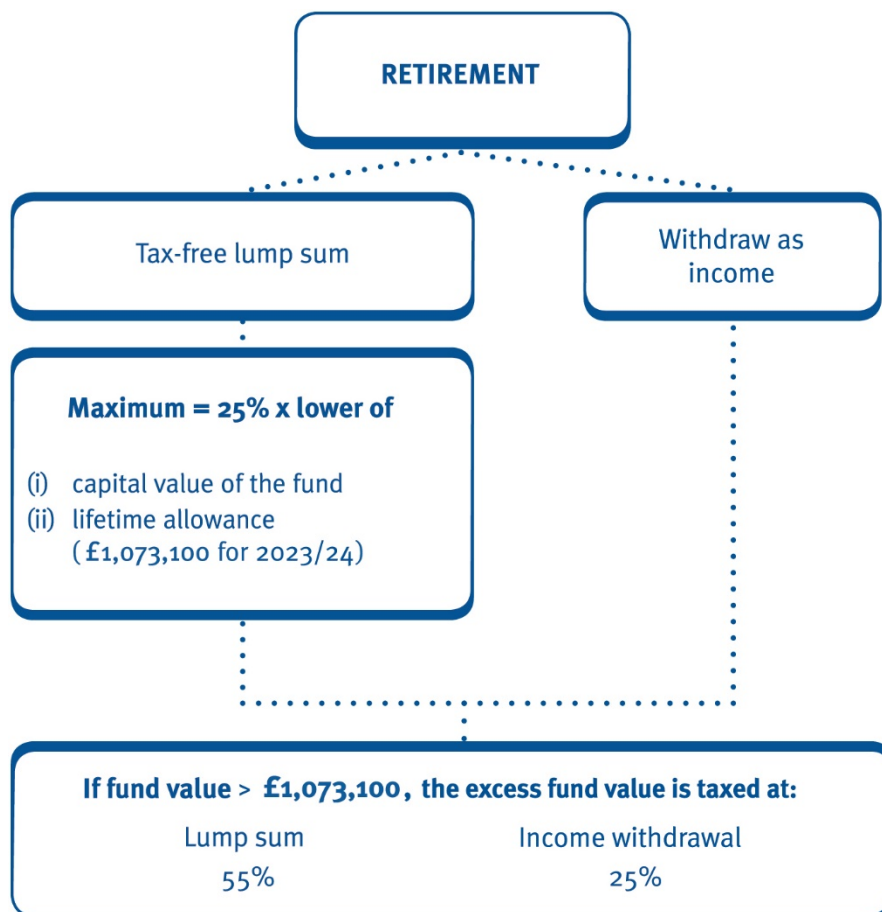
On the death of the individual, the pension scheme may provide:

- a pension income, and/or
- lump sums for dependants (e.g. spouse, civil partner, child under the age of 23 or other dependant).

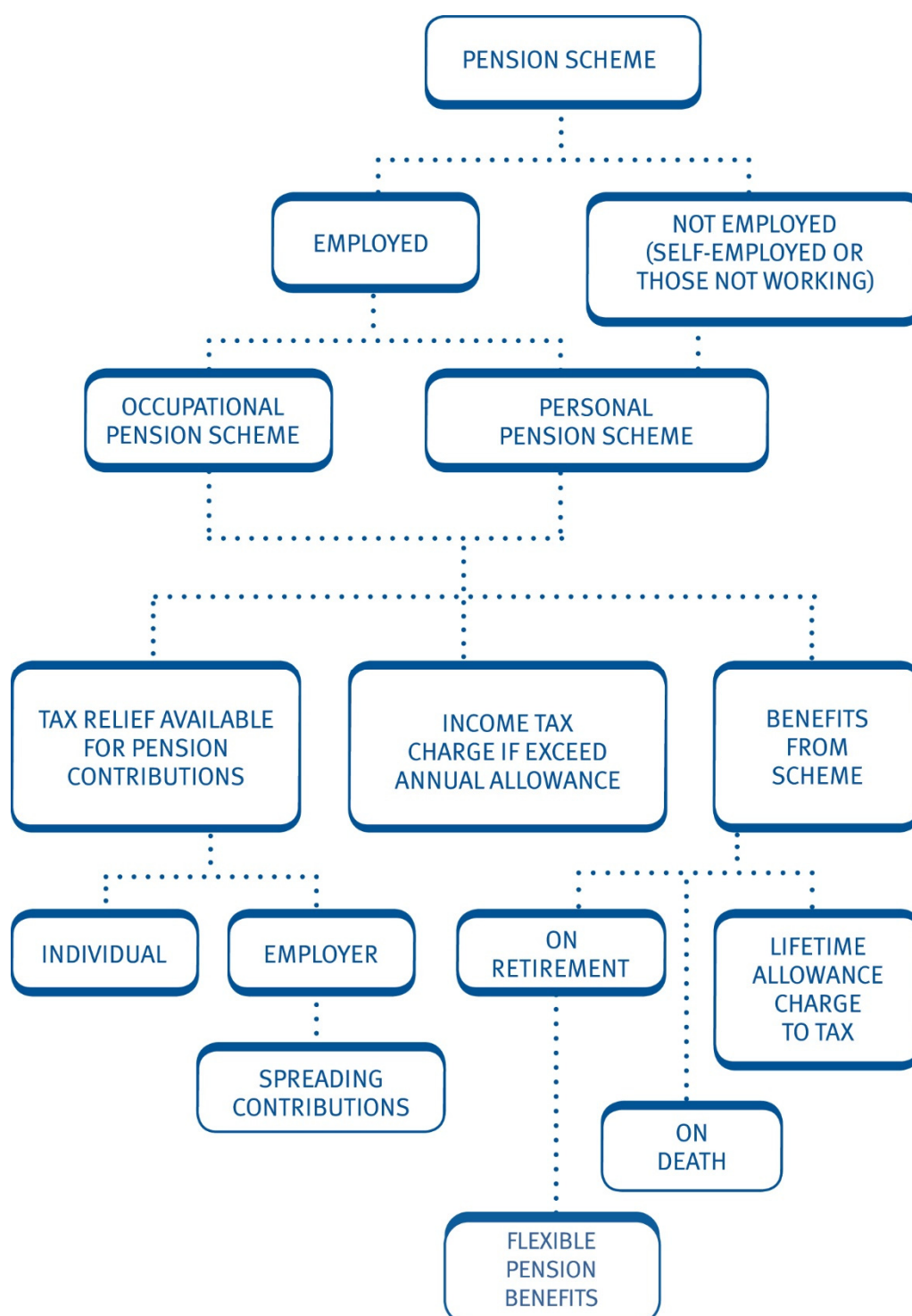
Further tax charges may arise depending on:

- the individual's age
- the individual's marginal rate of income tax
- whether the scheme is a money purchase or a defined benefit scheme
- whether any of the fund has already been utilised to provide benefits.

Summary



5 Chapter summary



Test your understanding answers



Test your understanding 1

Esma

- The tax relief available on Esma's pension contributions is restricted to 100% of her relevant earnings = £20,000.
- She will obtain basic rate tax relief at source of £4,000 ($£20,000 \times 20\%$) and pay £21,000 ($£25,000 - £4,000$) to the pension scheme.
- As Esma is not a higher rate taxpayer, no adjustment is required to her income tax computation.

Dante

- Dante's pension contributions are less than his relevant earnings for the year and he will therefore receive tax relief on the full amount of the contributions.
- He will obtain basic rate tax relief at source of £8,000 ($£40,000 \times 20\%$) and pay £32,000 ($£40,000 - £8,000$) to the pension scheme.
- Higher rate tax relief will be given by extending the basic rate band by £40,000 from £37,700 to £77,700.
- Dante's income tax computation for the tax year 2023/24 will be

	£	
Trading income	100,000	
Less: Personal allowance	(12,570)	
	<hr/>	
Taxable income (all non-savings income)	87,430	
	<hr/>	
Income tax liability		
	£	£
77,700	$\times 20\%$	15,540
9,730	$\times 40\%$	3,892
	<hr/>	<hr/>
87,430		19,432
	<hr/>	<hr/>



Test your understanding 2

Yoana

Income tax computation – 2023/24

			£
Salary			80,000
Less: Employee's pension contributions (3%)			(2,400)
			<hr/>
Employment income			77,600
Less: PA			(12,570)
			<hr/>
Taxable income			65,030
			<hr/>
Income tax:	£		£
Basic rate	37,700	× 20%	7,540
Higher rate	27,330	× 40%	10,932
	<hr/>		
	65,030		
	<hr/>		<hr/>
			18,472
			<hr/>

Note: The employer's contribution into her pension scheme is an exempt employment benefit and is therefore not taxable income for Yoana.

Yoana's occupational pension scheme contributions have reduced her taxable income by £2,400 and thus the amount of tax that she has paid at the 40% rate. She has therefore obtained tax relief at 40% for her pension contributions.

Lloyd Ltd will deduct the £2,400 from the amount of taxable pay from which income tax is deducted through the PAYE system.



Test your understanding 3

Damjan

	£
Unused allowances:	
2020/21 Contributions in excess of £40,000	0
2021/22 (£40,000 – £35,000)	5,000
2022/23 (£40,000 – £17,000)	23,000
	<hr/>
Total unused allowances b/f	28,000
Add: Allowance for 2023/24	40,000
	<hr/>
Maximum gross contribution for 2023/24 to avoid charge	68,000
	<hr/>

Hasan

	£
Unused allowances:	
2020/21 Not a member of a pension scheme	N/A
2021/22 (£40,000 – £5,000)	35,000
2022/23 (£40,000 – £6,000)	34,000
	<hr/>
Total unused allowances b/f	69,000
Add: Allowance for 2023/24	40,000
	<hr/>
Maximum gross contribution for 2023/24 to avoid charge	109,000
	<hr/>



Test your understanding 4

Ahmed

	Allowance available £	Used 2023/24 £	c/f £
Allowance for 2023/24	40,000	(40,000)	0
Unused allowances b/f			
2020/21 (£40,000 – £12,000)	28,000	(18,000)	0
2021/22 (£40,000 – £36,000)	4,000		4,000
2022/23 (£40,000 – £33,000)	7,000		7,000
	<hr/>	<hr/>	
	79,000	(58,000)	
	<hr/>	<hr/>	
Unused allowances c/f to 2024/25			11,000
			<hr/>

Note: The allowance for the current tax year must be used first, then the unused allowance b/f from the previous three years, starting with the earliest tax year.

The remaining allowance from the tax year 2020/21 of £10,000 (£28,000 – £18,000) cannot be c/f to 2024/25 as it is more than three years ago.



Test your understanding 5

Marcus

- Marcus can obtain tax relief for a gross pension contribution of up to a maximum of 100% of his relevant earnings = £110,000 in the tax year 2023/24. Therefore, relief will be available for the gross amount of £50,000.
- Marcus will have paid the pension contributions net of basic rate tax of £10,000 (£50,000 × 20%) and paid £40,000 (£50,000 × 80%) into the pension scheme.
- Higher rate relief is obtained by extending the basic rate band threshold by £50,000 from £37,700 to £87,700.
- Relief on £30,000 is given as an allowable deduction in computing the employer's taxable trading profits.
- The total gross contributions paid into the scheme in the tax year 2023/24 will be £80,000 (£50,000 + £30,000) which exceeds the annual allowance of £40,000.

- There is no annual allowance b/f as contributions of £50,000 in the previous three years were greater than the AA for each of those years.
- Marcus will therefore have an additional income tax liability in the tax year 2023/24 on £40,000 (£80,000 – £40,000).
- Marcus' income tax computation for the tax year 2023/24 will be:

		£
Employment income = net income		110,000
Less: PA (Note)		(12,570)
		<hr/>
Taxable income		97,430
		<hr/>
Income tax:		
	£	£
Extended basic rate band	87,700 × 20%	17,540
Higher rate band	9,730 × 40%	3,892
	<hr/>	
	97,430	
Annual allowance charge:		
Higher rate band	40,000 × 40%	16,000
		<hr/>
Income tax liability		37,432
		<hr/>

Note: There is a normal PA available as the ANI is £60,000 (£110,000 – £50,000).



Test your understanding 6

Threshold income:

	Ann £	Belinda £	Carol £	David £
Net income	190,000	215,000	250,000	270,000
Less: Individual's gross PPCs	(23,000)	(2,000)	(0)	(0)
	<hr/>	<hr/>	<hr/>	<hr/>
Threshold income	167,000	213,000	250,000	270,000
	<hr/>	<hr/>	<hr/>	<hr/>

Ann's threshold income is ≤ £200,000, therefore she will be entitled to the full AA in the tax year 2023/24.

For Belinda, Carol and David threshold income is > £200,000 and adjusted income needs to be calculated.

Adjusted income:

	Ann	Belinda	Carol	David
	£	£	£	£
Net income		215,000	250,000	270,000
Plus: Employee OPCs		0	12,000	20,000
Employer's contributions		0	20,000	28,000
Adjusted income	N/A	215,000	282,000	318,000

Belinda does not have any occupational pension contributions or employer contributions so net income = adjusted income. Her adjusted income is < £240,000 and therefore no restriction of the AA is required.

For Carol and David, it is necessary to restrict the AA as adjusted income is > £240,000.

Annual allowance for 2023/24:

	Ann	Belinda	Carol	David
	£	£	£	£
Annual allowance	40,000	40,000	40,000	40,000
Less: Reduction in allowance				
(£282,000 – £240,000) × 50%			(21,000)	
(£318,000 – £240,000) × 50% = £39,000 (restricted)				(36,000)
Revised annual allowance	40,000	40,000	19,000	4,000



Test your understanding 7

Emily

Income tax computation – 2023/24 with no pension contributions

	£
Employment income = total income	130,000
Less: Adjusted PA (Note)	(0)
	<hr/>
Taxable income	130,000
	<hr/>

Income tax	£		£
Non-savings – basic rate	37,700	× 20%	7,540
Non-savings – higher rate	87,440	× 40%	34,976
	<hr/>		
	125,140		
Non-savings – additional rate	4,860	× 45%	2,187
	<hr/>		
	130,000		
	<hr/>		
Income tax liability			44,703
			<hr/>

Note: In this example, as total income = net income = ANI, and this is greater than £125,140 (£100,000 plus double the PA), the PA is reduced to £Nil.

Income tax computation – 2023/24 with pension contributions

	£
Employment income = total income	130,000
Less: PA (W)	(12,570)
	<hr/>
Taxable income	117,430
	<hr/>

Gross pension contribution = (£24,000 × 100/80) = £30,000

Higher rate threshold = (£37,700 + £30,000) = £67,700

Income tax	£		£
Non-savings – basic rate	67,700	× 20%	13,540
Non-savings – higher rate	49,730	× 40%	19,892
	<hr/>		
	117,430		
	<hr/>		
Income tax liability			33,432
			<hr/>

Tax saving		£
Tax saved in computation (£44,703 – £33,432)		11,271
Tax saved at source (£30,000 – £24,000)		6,000
		<hr/>
Total saving		17,271
		<hr/>
Working: Adjusted PA	£	£
Personal allowance		12,570
Net income	130,000	
Less: Gross pension contribution	(30,000)	
	<hr/>	
Adjusted net income	100,000	
Less: Income limit	(100,000)	
	<hr/>	
	0	
	<hr/>	
Reduction of PA		0
		<hr/>
Adjusted PA		12,570
		<hr/>
Alternative calculation		
The tax saving can be calculated more quickly without doing full income tax computations, by using Emily's marginal rate of tax.		
The availability of the personal allowance will save tax and will also mean that income previously taxed at the additional rate of 45% will now be taxed at 40%. In addition, the extension of Emily's basic rate band will mean that income previously taxed at 40% will now be taxed at 20%, as follows:		
		£
Tax saved by personal allowance (£12,570 × 40%)		5,028
Income no longer in additional rate band (45% – 40%) × (£130,000 – £125,140)		243
Tax saved by gross pension contribution:		
At source (payment made net of 20% tax) (20% × £30,000)		6,000
By extension of basic rate band (40% – 20%) × £30,000		6,000
		<hr/>
Total saving (as above)		17,271
		<hr/>
Where possible, to save time, you should always try to calculate tax savings using marginal rates in the examination.		

Overseas aspects of income tax and capital gains tax

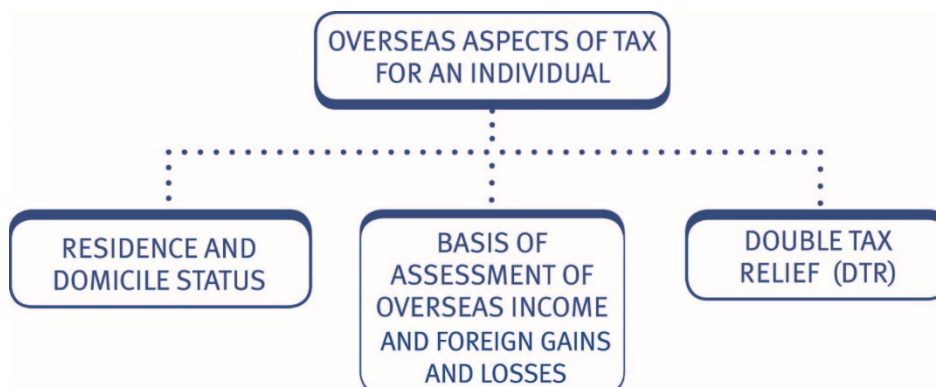
Chapter learning objectives

Upon completion of this chapter you will be able to:

- explain and apply the concepts of residence, domicile and deemed domicile and advise on the relevance to income tax and capital gains tax
- advise on the availability of the remittance basis to UK resident and non-UK domiciled individuals
- advise on the tax position of individuals coming to and leaving the UK
- determine the income tax treatment of overseas income from trading, employment and investment
- understand the relevance of the OECD model double tax treaty to given situations
- calculate and advise on the double taxation relief available to individuals
- determine the UK taxation treatment of foreign gains, including double taxation relief
- conclude on the capital gains tax position of individuals coming to and leaving the UK
- advise on the UK taxation of gains on the disposal of UK land and buildings owned by non-residents.



One of the PER performance objectives (PO17) is to assess the tax implications of proposed activities or plans, referring to up-to-date legislation. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter explains the rules for determining the tax status of an individual and covers the overseas aspects of both income tax and capital gains tax.

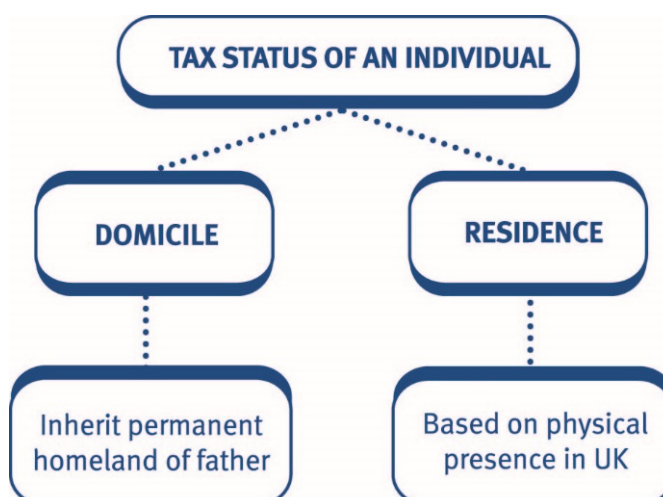


The concept of residence was covered in TX. At ATX we introduce the concept of domicile and look at the implications of an individual's residence and domicile for tax purposes.

1 The tax status of an individual

The tax status of an individual is fundamental in determining the basis of assessment for both income tax and capital gains tax.

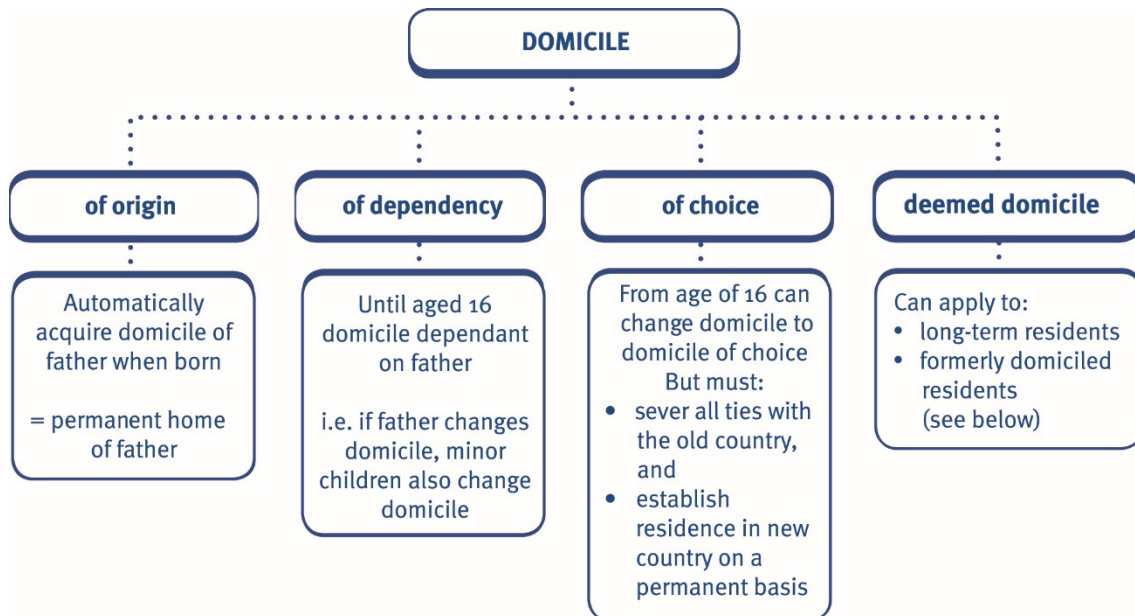
Determining whether or not an individual has UK residence and domicile is therefore vital.





Domicile

The domicile status of an individual differs from the concepts of nationality and residence, it is based on the individual's permanent home. A person can only have one domicile at any one time.



Deemed domicile

There are two situations in which a non-UK domiciled individual can be **deemed** to be UK domiciled for the purposes of income tax and capital gains tax.

Long term residents

- An individual is deemed to be UK domiciled in a tax year if the individual has been UK resident for **15 of the previous 20** tax years (including split years – see later).

Exception: long term residents will not be deemed domiciled if they have not been UK resident in any tax year commencing after 5 April 2017.

Formerly domiciled residents

- An individual is deemed domiciled in a tax year if the individual:
 - was born in the UK, and
 - has a domicile of origin in the UK, and
 - is UK resident in that tax year.

Deemed domiciled individuals are not able to **claim** the remittance basis for income tax or capital gains tax but may sometimes still be able to access it automatically (see later).



Illustration 1 – Deemed domicile

Mikael

Mikael was born in Sweden to Swedish domiciled parents, but came to the UK to live and work on 5 April 2003. It has always been Mikael's intention to return to Sweden when he retires, and he has kept a family home there.

Louisa

Louisa was born in the UK and both of her parents have always been UK domiciled. Louisa moved to Germany in 2019 to live and work, and chose to change her domicile.

However, Louisa's mother fell ill recently and as a result Louisa spent most of the 2023/24 tax year in the UK, causing her to become UK resident for that year. Once her mother has recovered, Louisa intends to return to Germany.

Explain whether or not Mikael and Louisa are deemed to be UK domiciled in the tax year 2023/24, for the purposes of income tax and capital gains tax.

Solution

Mikael

Mikael is an example of a long-term resident.

Prior to the 2023/24 tax year he has been resident in the UK for the past 20 tax years, which is at least 15 out of the previous 20 tax years. He will, therefore, be deemed to be UK domiciled in the tax year 2023/24.

Note that if Mikael had ceased to be UK resident from 6 April 2017 then he would not be deemed domiciled in the tax year 2023/24, despite being UK resident for 15 out of the previous 20 tax years.

Louisa

Louisa is an example of a formerly domiciled resident.

Even though she has changed her domicile for general purposes, she will be deemed to be UK domiciled in the tax year 2023/24 for the purposes of income tax and capital gains tax, as:

- she was born in the UK
- she has a UK domicile of origin (her father was, and always has been, UK domiciled), and
- she is UK resident in the tax year 2023/24.

As long as Louisa is not UK resident in the following tax years, she will revert to being non-UK domiciled going forwards.

Residence



Definition of residence

An individual is UK resident in the tax year if the individual:

- does not meet one of the **automatic non-UK residence tests** (also referred to as automatic overseas residence tests), and
- meets one of the **automatic UK residence tests**, or
- meets one or more of the **sufficient ties tests** and has been in the UK for a sufficient length of time.

These rules are complex in practice. However, the ATX examining team have confirmed that the following simplified rules are to be applied in the ATX exam.

Note that under these rules an individual is either UK resident or non-UK resident for the whole of a tax year.

Procedure to determine residence

Step 1	Check automatic non-UK residence tests <ul style="list-style-type: none"> • If satisfy one test = non-UK resident • If not = go to Step 2
Step 2	Check automatic UK residence tests <ul style="list-style-type: none"> • If satisfy one test = UK resident • If not = go to Step 3
Step 3	<ul style="list-style-type: none"> • Determine how many sufficient ties within the UK exist, and • How many days are spent in the UK in the tax year, then • Use tax tables to decide status

The order of the procedure is important because it is possible for an individual to satisfy both one of the automatic non-UK residence tests and one of the automatic UK residence tests.

If this is the case, the non-UK residence test takes priority and the decision is made at Step 1. There is no need to continue on to Step 2.

Automatic non-UK residency tests

An individual is automatically **not** UK resident if that individual is 'in the UK' **in the tax year** for **less than**

- **16 days**, and has been UK resident for one or more of the previous three tax years, or
- **46 days**, and has not been UK resident in any of the previous three tax years, or
- **91 days**, and works full time overseas.

Note that an individual is 'in the UK' if that individual is in the UK at midnight.

Automatic UK residency tests

An individual is automatically UK resident if that individual is in the UK for at least:

- **183 days** in the **tax year**, or
- **30 days** in the **tax year**, and the individual's only home is in the UK, or
- **365 days continuously** working full time, some of which fall in the tax year.

These are the simplified rules which will be examinable. More detailed rules are given in supplementary reading.



More detail on second test

The second test requires that within a period of 91 consecutive days, **the individual spends at least 30 days in the tax year in the UK home** and if the individual also has an overseas home, spends fewer than 30 days in the tax year in that overseas home.

If the individual does not satisfy any of the automatic tests, the tax status is determined by:

- how many of the five 'sufficient ties tests' are satisfied, and
- the number of days spent in the UK.

Sufficient ties tests

To determine whether or not the individual is sufficiently connected to the UK to be considered UK resident, HMRC will look at the following five ties:

	This tie with the UK exists if the individual:
(1) Family	Has close family (a spouse or civil partner or minor children) in the UK that are UK resident
(2) Accommodation	Has a house in the UK which is made use of during the tax year and is available for at least 91 consecutive days during the tax year
(3) Work	Does substantive work in the UK (i.e. at least 40 days)
(4) Days in UK	Has spent more than 90 days in the UK in either, or both, of the previous two tax years
(5) Country	Spends more time in the UK than in any other country in the tax year

These are the simplified rules which will be examinable. More detailed rules are given in supplementary reading.



More detail on sufficient ties tests

Family: This tie with the UK exists if the individual has a

- spouse or civil partner (or is living with a partner as if married or civil partners), or children under 18 years old who are UK resident.

Accommodation: This tie with the UK exists if the individual has a

- place in the UK available to live in for 91 consecutive days or more during the tax year and stays there in that tax year for:
 - at least one night, or
 - at least 16 nights (if it is the home of a close relative).

Note that the accommodation does not need to be owned by the individual.

Note that for an individual

- leaving the UK (previously resident) i.e. UK resident for one or more of the previous three tax years:
 - **all five ties** are relevant to decide the tax status
- arriving in the UK (not previously resident) i.e. **not** U.K resident for any of the previous three tax years:
 - only the **first four ties** are relevant (i.e. ignore the country tie).

Individuals leaving the UK and arriving in the UK

In summary, to determine the tax status of the individual, consideration is given to:

- the automatic 'non-UK residency' and 'UK residency tests', and then if none of the automatic tests are met
- how many of the 'sufficient ties tests' are satisfied, together with
- the number of days spent in the UK

as shown in the table at the end of this section.

Days in the UK	Previously resident	Not previously resident
Less than 16	Automatically not resident	Automatically not resident
16 to 45	Resident if 4 UK ties (or more)	Automatically not resident
46 to 90	Resident if 3 UK ties (or more)	Resident if 4 UK ties
91 to 120	Resident if 2 UK ties (or more)	Resident if 3 UK ties (or more)
121 to 182	Resident if 1 UK tie (or more)	Resident if 2 UK ties (or more)
183 or more	Automatically resident	Automatically resident



Note that this table will be given in the tax rates and allowances provided in the examination.

These rules mean it is more difficult for a person leaving the UK to lose UK residency status than it is for a person arriving in the UK to remain non-UK resident.



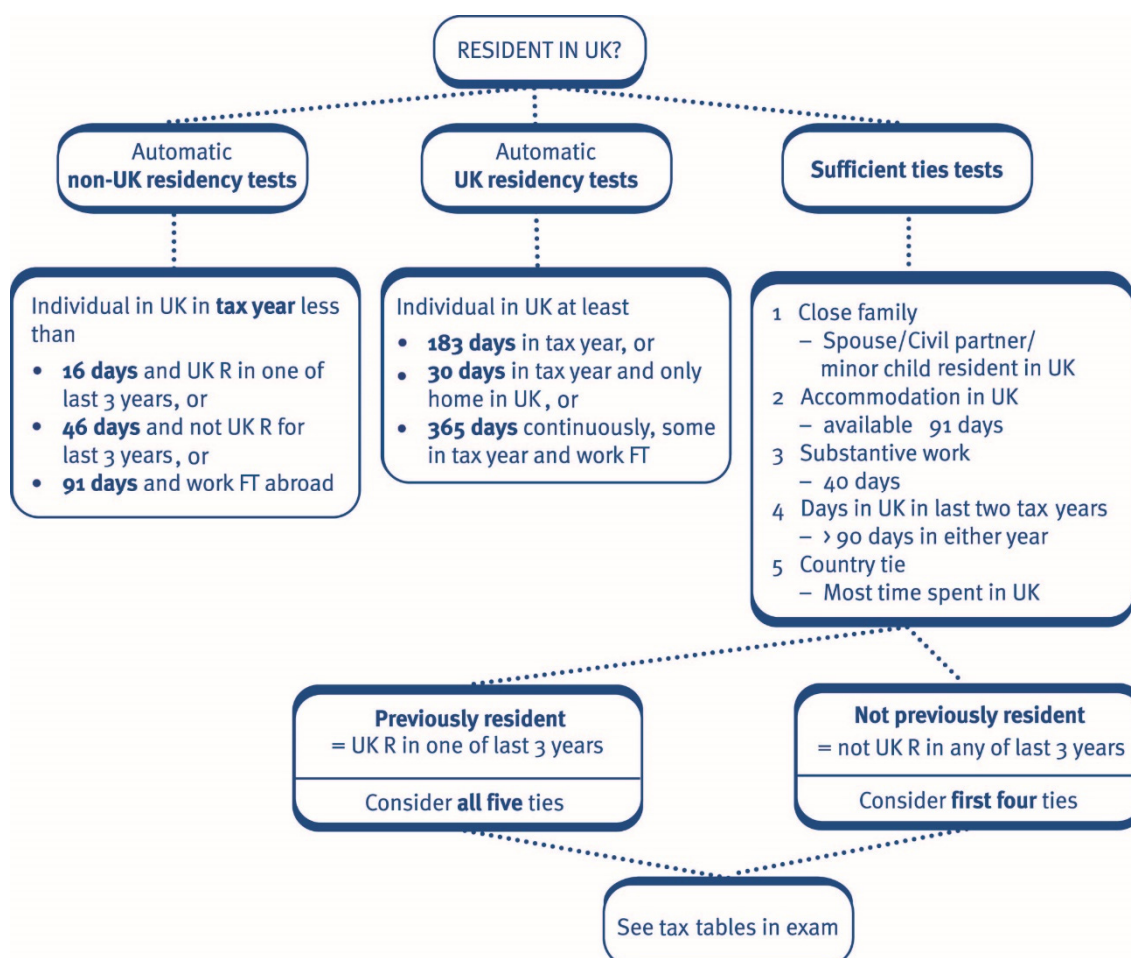
Test your understanding 1

Explain whether or not the following individuals are resident in the UK in the tax year 2023/24.

- Jean-Paul was born in France. He has lived in his home town in France until the tax year 2023/24 when he came to the UK to visit on 11 May 2023 until 17 December 2023.
- Carmen who is retired, was born in Spain. She has lived in her home town in Spain until the tax year 2023/24 when she came to the UK to visit for a month.
- Khalil, who is unmarried, has always been UK resident until 5 April 2023 when he gave up work and on 1 May 2023 he left the UK for a year visiting his friends abroad, returning on 1 May 2024.
He did not spend more than a month in any other country whilst he was away, except for a three month stay (November to January inclusive) in his villa in Florida.
Whilst he was away he rented out his UK home.

- (iv) On 6 April 2023 Bruce purchased a flat in London. He had previously visited the UK on holiday for a fortnight in each of the last four years and was treated as not UK resident in those years.
- In the tax year 2023/24 he visited the UK and stayed in his flat in London for the summer from 25 May 2023 to 30 September 2023. He worked as a waiter for four weeks of that time.
- The remainder of the year he worked in his home town of Brisbane in Australia and lived in his house in the suburbs of the town.

Summary of residency rules



2 Splitting a tax year

Normally the **tax status of an individual is fixed for a whole tax year**.

However, there are some circumstances where **a tax year can be split** and an individual is deemed to be UK resident for only part of the year (UK part) and not UK resident for part of the year (overseas part).

Note that:

- the split year basis (SYB) applies automatically if conditions are satisfied; there is no claim to be made
- it is not possible to disapply the SYB
- if an individual is non-UK resident for the tax year under the automatic tests or sufficient ties tests:
 - the SYB cannot apply to that year
 - the individual is non-UK resident for the whole year.

Accordingly, for the SYB to apply, **the individual must be UK resident in the tax year** under the automatic tests or the sufficient ties tests.

The way the SYB works depends on whether the individual is leaving the UK or arriving into the UK as follows.

Leaving the UK	
SYB applies in the current tax year if the individual: <ul style="list-style-type: none"> • is UK resident in previous year, and • is UK resident in the current tax year, and • is not UK resident in the following year, and • leaves the UK part way through the current tax year for one of three reasons below. 	
Individual leaves the UK and:	Overseas part starts from:
(1) Begins working abroad <ul style="list-style-type: none"> – Full time, and – Does not spend more than a permitted number of days in the UK after departure (< 91 days per tax year, reduced proportionately in year of departure) 	Date starts overseas work

<p>(2) Accompanies or later joins a partner abroad to continue to live with that partner</p> <ul style="list-style-type: none"> – As the partner leaves the UK and satisfies the full time working abroad situation 1 above in the current year or previous year – Provided does not spend more than a permitted number of days in the UK after departure (< 91 days per tax year, reduced proportionately in year of departure) – The partner is a spouse, civil partner or person with whom the individual has lived as if married or civil partners at some point during the current or previous tax year – Has no home in the UK or if does, spends the greater part of the time in the overseas home 	<p>Later of date</p> <ul style="list-style-type: none"> • partner starts overseas work • joins partner
<p>(3) Ceases to have any UK home</p> <ul style="list-style-type: none"> – After ceasing to have a UK home, spends minimal time in the UK (< 16 days), and – Establishes ties with the overseas country (e.g. buys a home abroad, becomes resident in overseas country, spends more than six months in overseas country) 	<p>Date cease to have a UK home</p>

Note: Where the SYB can apply under more than one of the above situations, priority is given in the order above (i.e. Situation 1, 2 and then 3).



Test your understanding 2

Helen has been living in the UK since she was born and is UK resident for tax purposes. She has worked in the publishing industry for four years but leaves her job to take up a two-year contract as a lecturer in Dubai.

She started work in Dubai on 1 November 2023, one week after she moved there, and has moved into a company provided flat for the duration of her contract.

She returns to visit her family in the UK over the New Year for two weeks, and does not work while she is there.

Helen remains working in Dubai throughout the tax year 2024/25, and only returns for two weeks in the summer.

Explain whether the split year basis will apply in the tax year 2023/24 and if so, define the UK part and overseas part of the tax year.

Arriving in the UK	
SYB applies in the current tax year if the individual:	
<ul style="list-style-type: none"> • is not UK resident in the previous year, and • is UK resident in the current tax year • arrives in the UK part way through the current tax year for one of four reasons below. 	
Individual arrives the UK and:	UK part starts from:
(1) Acquires a UK home <ul style="list-style-type: none"> – Did not have sufficient ties in the UK to be UK resident prior to acquiring a UK home 	Date acquires UK home
(2) Begins working in the UK <ul style="list-style-type: none"> – Full time – For ≥ 365 continuous days, and – Did not have sufficient ties in the UK to be UK resident prior to entry 	Date start work in UK

<p>(3) Ceases work abroad and returns to the UK</p> <ul style="list-style-type: none"> – Following a period when the individual worked full time overseas, and – Is resident in the UK in the following tax year 	<p>Date individual stops working overseas</p>
<p>(4) Accompanies or later joins a partner in UK to continue to live with that partner</p> <ul style="list-style-type: none"> – As the partner returns to the UK and satisfies the situation 3 above in the current year or previous year – the partner is a spouse, civil partner or person with whom the individual has lived as if married or civil partners at some point during the current or previous tax year – Is resident in the UK in the following tax year 	<p>Later of date</p> <ul style="list-style-type: none"> • partner stops overseas work • joins partner in UK

Note: Where the SYB can apply under more than one of the above situations, priority is given to the situation which results in the smallest 'overseas part'.



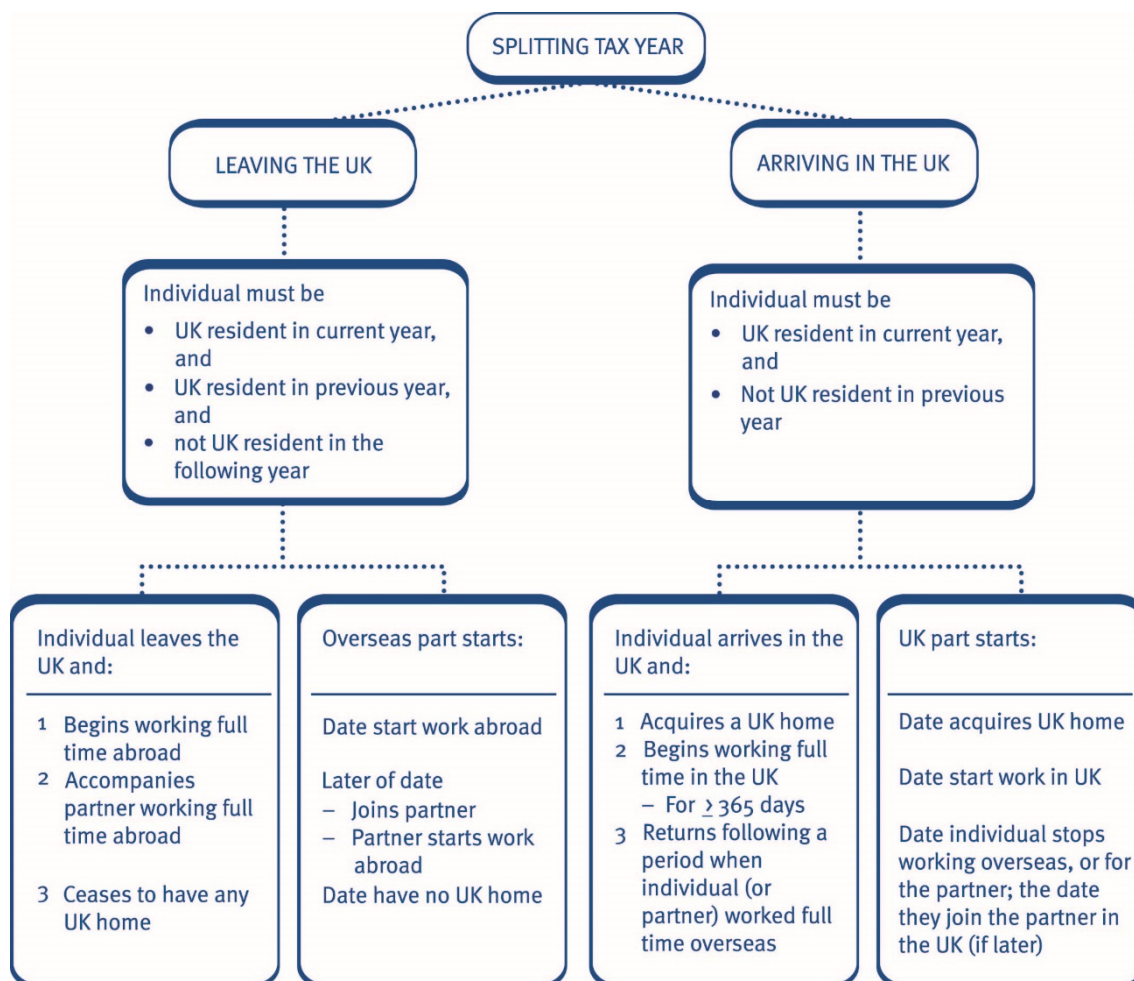
Test your understanding 3

Bjorn has been working part-time for his employer in Sweden for many years but on 1 July 2023 he came to the UK in search of alternative employment. He had no UK ties and has not been resident in the UK in the past.

In the UK he temporarily stayed with a friend until he secured a full-time three-year contract of employment and a house to rent in Nottingham. He signed a three-year lease agreement, moved into the house on 1 August 2023 and started work on 22 August 2023.

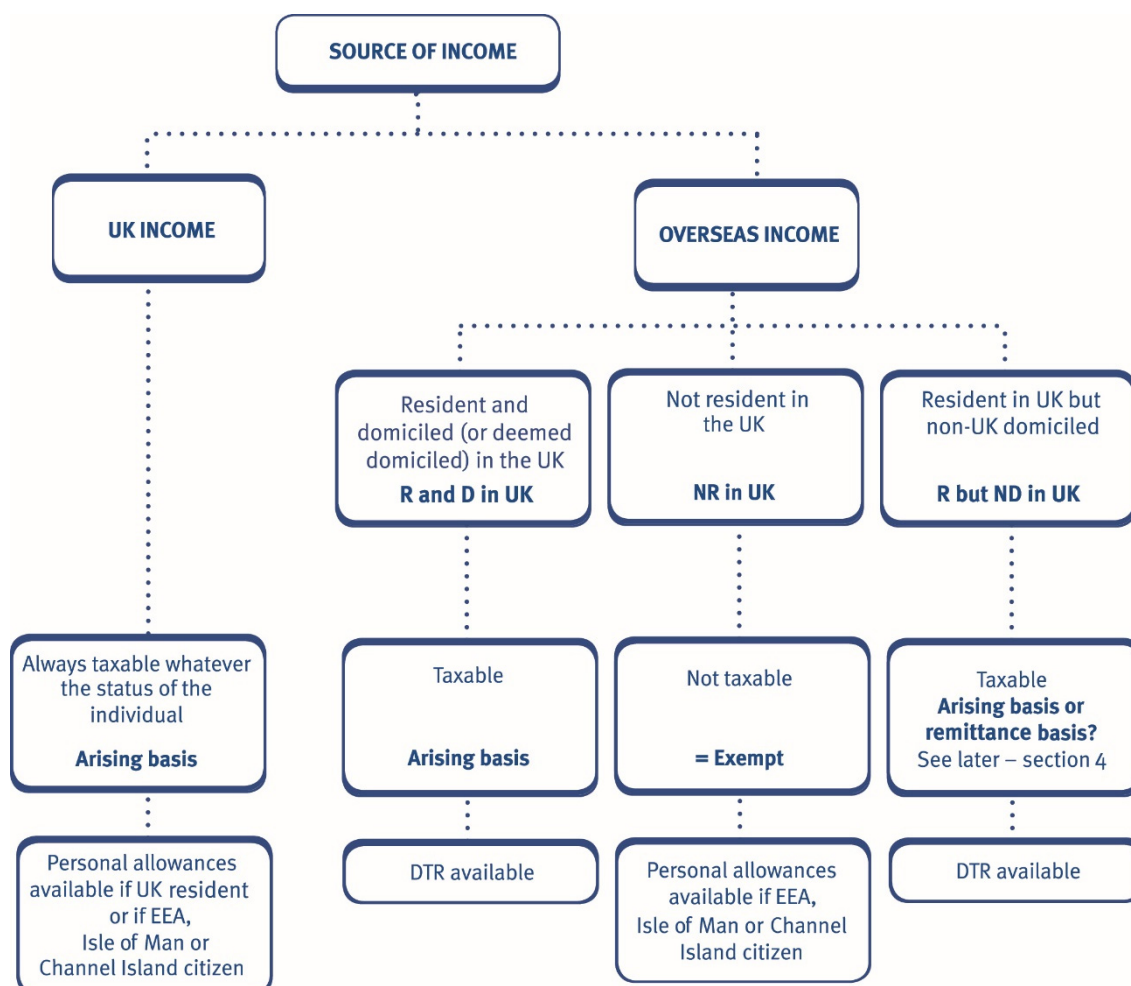
Explain whether the split year basis will apply in the tax year 2023/24 and if so, define the UK part and overseas part of the tax year.

Summary of split year basis





3 Overseas income – basis of assessment for income tax



Types of overseas income

The following sources of overseas income may be included in an individual's UK income tax computation:

Source of overseas income	Basis of assessment
Dividends, rental income and interest	<ul style="list-style-type: none"> Income grossed up for overseas tax suffered UK residents owning shares in an overseas company will treat the grossed up overseas dividends like UK dividends If overseas dividends or savings income are taxed on a remittance basis (see later), the income is taxed at non-savings rates (and the savings and dividend nil rate bands do not apply) DTR may be available
Trading income from business wholly abroad	<ul style="list-style-type: none"> Calculate trading income as in the UK Income grossed up for overseas tax suffered DTR may be available
Property income	<ul style="list-style-type: none"> Calculate property income as in the UK Keep overseas property income separate from any UK property income Income grossed up for overseas tax suffered If a loss arises on the overseas property business it may only be carried forward against future profits from the overseas property business DTR may be available

Source of overseas income	Basis of assessment
Pensions	<ul style="list-style-type: none"> Income grossed up for overseas tax suffered DTR may be available
Employment income	<ul style="list-style-type: none"> Assessment rules are basically the same as for other overseas income Some exceptions, but these are not examinable in ATX

Examination questions on overseas aspects

A common examination scenario is to consider an individual who leaves the UK and possibly satisfies the conditions such that the split year basis applies.

In test your understanding 2 in section 2, we determined the tax status of Helen for the tax years 2022/23 to 2024/25.

The next test your understanding takes this example on to determine the basis of assessment as a result of her status and the calculation of her taxable income.



Test your understanding 4

Assume that Helen (in test your understanding 2) actually finishes her contract in Dubai on 30 November 2025 and immediately returns to the UK and moves back into her home. She starts full time work for a UK publishing company on 1 December 2025.

Helen has a villa in Italy which generates rental income of £12,000 p.a. and during her time in Dubai Helen lets her home in the UK for £15,000 p.a.

- Explain whether the split year basis will apply in the tax year 2025/26 and if so, define the UK part and overseas part of the tax year.**
- Compute Helen's taxable property income for all tax years she is in Dubai.**
- Compute Helen's taxable property income for all tax years she is in Dubai assuming the split year basis does not apply and she is treated as UK resident in the tax years 2023/24 and 2025/26, but not UK resident in 2024/25.**



4 The remittance basis of assessment for overseas income

In section 3 we saw that if an individual is **resident** in the UK but is **not UK domiciled**, the individual is assessed to tax on **either an arising or remittance basis**.

Under the **remittance basis**, only **overseas income brought to the UK** will be taxed, whereas under the **arising basis**, **all overseas income** will be taxed.



More detail on the definition of remittance

The term remittance includes

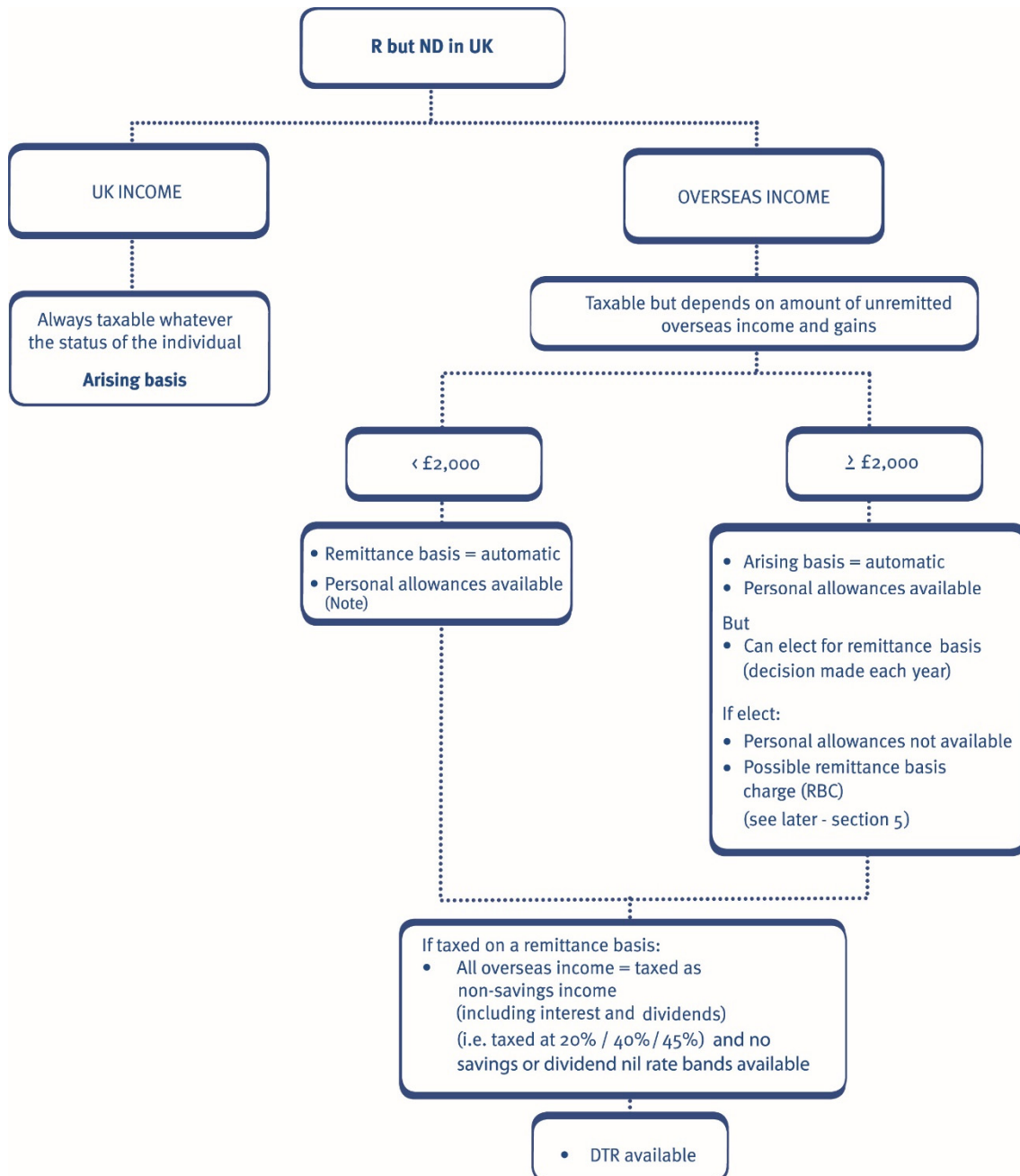
- (1) Bringing overseas income directly into the UK (with some exceptions).
- (2) Using overseas income to settle debts in the UK.
- (3) Using overseas income to purchase goods and services which are subsequently brought into the UK (with some exceptions).

However, you are not expected to know this level of detail in the ATX exam.

In some circumstances individuals will have no choice; however, in other circumstances they may be able to choose the basis on which they will be assessed to income tax and capital gains tax.

Consequences of being resident and non-UK domiciled

The rules depend on the level of unremitted income and gains in the tax year and the consequences are summarised as follows:



Note:

The remittance basis will still be automatically available for deemed domiciled individuals if their unremitted overseas income and gains are under £2,000.



Test your understanding 5

Ewa, a Polish national, has been resident in the UK for the last two years. She has her own self-employed hairdressing business and earns £25,000 in the UK. She also has £3,000 (gross) property income from Polish property that she does not remit to the UK.

Calculate Ewa's income tax liability for the tax year 2023/24 assuming that the election for the remittance basis

- (a) is not made
- (b) is made.



5 The remittance basis charge (RBC)

The RBC was introduced to prevent long-term residents deliberately using the remittance basis rules to avoid paying UK income tax and capital gains tax by not remitting income and gains each year.

The RBC is an additional tax charge that is added to the individual's income tax liability and is paid under self-assessment.

Additional charge:	UK resident for:
£30,000 p.a.	7 out of last 9 tax years
£60,000 p.a.	12 out of last 14 tax years



The above table is provided in the tax rates and allowances in the examination.

Note that for this purpose a 'split year' (see section 2) counts as a tax year of UK residence.

However, note that the RBC aims to penalise **long-term UK residents** who are **not UK domiciled**.

It is therefore only levied if the individual:

- is aged ≥ 18 years old in the tax year
- is not UK domiciled
- is UK resident in the current year, and
- has been UK resident for at least 7 out of the last 9 tax years
- has unremitted income and gains \geq £2,000, and
- elects for the remittance basis to apply.



Test your understanding 6

The following details relate to four different individuals who are all non-domiciled in the UK and are all taxed using the remittance basis.

	Ivor	Sasha	Juan	Pierre
Became resident in UK	2018/19	2010/11	2014/15	2002/03
Overseas income and gains not remitted to UK	£180,000	£220,000	£300,000	£1,900
Resident in UK	5 years	13 years	9 years	21 years

What RBC does each have to pay (if any) for the tax year 2023/24?



Illustration 2 – The remittance basis charge

Diego and Valentina are both domiciled in the USA but have been resident in the UK for the last 10 years. Their income for the tax year 2023/24 is as follows:

	Diego	Valentina
	£	£
Overseas income	300,000	40,000
Remitted to the UK (of above)	55,000	18,000

Decide whether or not Diego and Valentina should elect for the remittance basis to apply. Assume they have no UK income.

Solution

Diego will be better off if he claims the remittance basis and pays tax on £55,000 as well as paying the £30,000 charge:

	Arising basis	Remittance basis
	£	£
Income	300,000	55,000
Less: PA (Notes 1 and 2)	0	0
	<hr/>	<hr/>
Taxable income	300,000	55,000
	<hr/>	<hr/>

Income tax:

£	£		£	£
37,700	37,700	at 20%	7,540	7,540
87,440	17,300	at 40%	34,976	6,920
174,860	–	at 45%	78,687	–
<hr/>	<hr/>			
300,000	55,000			
<hr/>	<hr/>			
Add: RBC				30,000
			<hr/>	<hr/>
Total liability			121,203	44,460
			<hr/>	<hr/>

Valentina will be better off if she pays tax on the arising basis:

	Arising basis	Remittance basis
	£	£
Income	40,000	18,000
Less: PA	(12,570)	0
	<hr/>	<hr/>
Taxable income	27,430	18,000
	<hr/>	<hr/>
Income tax		
£27,430/£18,000 at 20%	5,486	3,600
Add: RBC		30,000
	<hr/>	<hr/>
Total liability	5,486	33,600
	<hr/>	<hr/>

Notes:

- (1) Under the arising basis, Diego's PA is reduced to £Nil as his adjusted net income is > £125,140.
- (2) Under the remittance basis, the PA is not available.



Test your understanding 7

Gita, who is domiciled in Germany, has been resident in the UK since the tax year 2011/12.

In the tax year 2023/24 she had taxable UK trading profits of £90,000. She also has significant overseas investments which generated gross interest of £63,000 and gross rental income of £95,000.

Gita remits £10,000 of overseas interest into the UK each year and none of her rental income.

Calculate Gita's income tax liability for the tax year 2023/24 assuming:

- (a) **she does not claim the remittance basis**
- (b) **she does claim the remittance basis.**



Nominating income and gains

The RBC represents tax paid in advance on income/gains arising abroad but not yet remitted into the UK. The individual can choose which overseas income or gains the charge relates to.

When these nominated amounts are remitted, they are not taxed again. However, un-nominated income/gains are deemed to be remitted first.



6 Double taxation relief – income tax

As seen in section 3, an individual who is:

- Resident and domiciled or deemed domiciled in the UK
= taxed in the UK on worldwide income (UK and overseas income)
- Resident in the UK, but non-UK domiciled
= taxed in the UK on overseas income on either an arising or remittance basis, and on UK income

However, in addition, the overseas income may also be subject to income tax overseas. To avoid a double charge to tax, double taxation relief (DTR) is available.

DTR is given in one of three ways:

- Under a DTR treaty agreement
- As a tax credit relief (known as 'unilateral relief')
- As an expense relief (only applicable where the individual has losses and unilateral relief is not available).

However, in computational **examination questions**, **unilateral relief** is to be applied. This is because expense relief is not examinable, and detailed knowledge of specific DTR agreements will not be examined.

You should have an awareness of standard treaty clauses and the importance of bilateral DTR agreements in practice, but you will not be expected to apply treaty provisions in the exam.

Further details of the principles behind DTR treaty agreements are given in supplementary reading. In addition, as DTR treaties are more relevant in the examination in a corporate scenario, more detail concerning standard treaty clauses is given in Chapter 5.



DTR treaties

Many tax treaties are based on the OECD (Organisation for Economic Co-operation and Development) model and typically have the following features:

- The two countries usually agree reciprocal arrangements to exempt certain types of income from tax in the overseas country so that there is no double taxation, and
- Allow 'unilateral relief' as a tax credit from the UK income tax liability for any overseas income that is still taxed twice.

Relief under the terms of a treaty is the usual method of relief in practice. The UK has over a hundred DTR treaties with different countries.

Unilateral relief

Where there is no DTR treaty agreement, DTR is normally allowed as a tax credit deduction against the UK income tax liability.

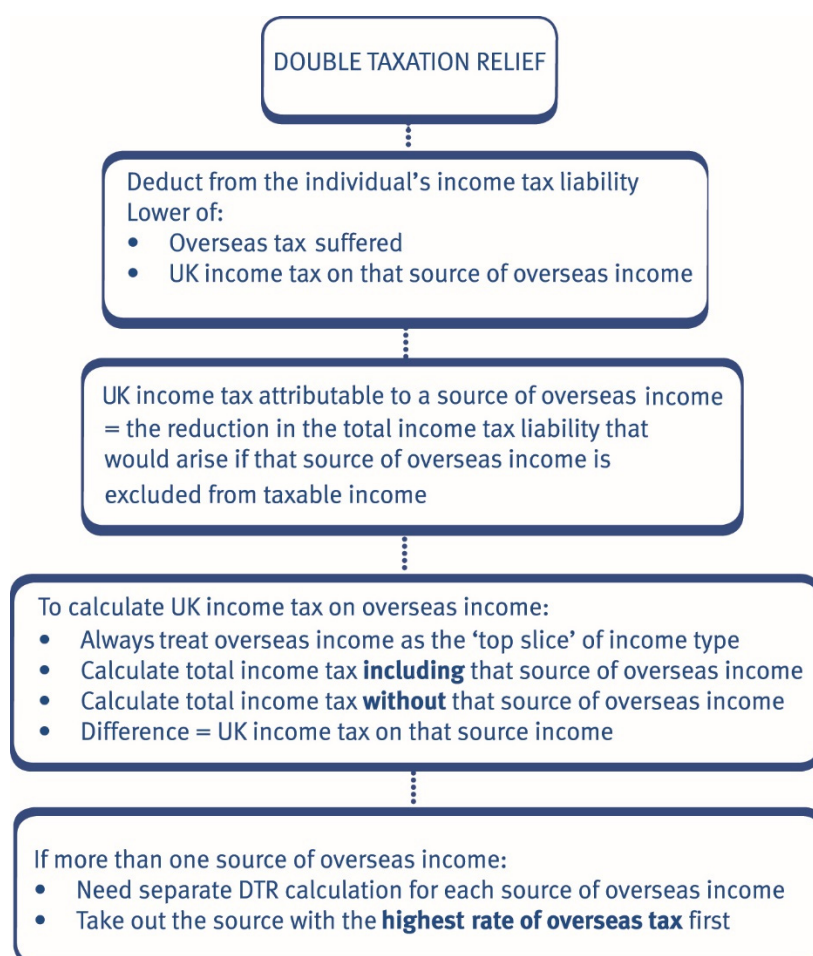


Illustration 3 – Double tax relief

Hussein is resident and domiciled in the UK. In the tax year 2023/24 his only taxable income is an overseas dividend of £47,500 and UK property income of £20,000. The dividend is received after deduction of 5% foreign withholding tax.

Calculate Hussein's UK income tax liability in the tax year 2023/24.

Solution

Income tax computation – 2023/24		£
Property income		20,000
Overseas dividend		
(£47,500 × 100/95)		50,000
		<hr/>
Total income		70,000
Less: PA		(12,570)
		<hr/>
Taxable income		57,430
		<hr/>

Analysis of income**Dividends**

£50,000

Non-savings income

(£57,430 – £50,000) = £7,430

	£		£
Non-savings income	7,430	× 20%	1,486
DNRB	1,000	× 0%	0
Dividend income	29,270	× 8.75%	2,561
	<u>37,700</u>		
Dividend income	19,730	× 33.75%	6,659
	<u>57,430</u>		<u>10,706</u>
Less: DTR			
Lower of			
(i) Overseas tax = (£50,000 × 5%) = £2,500			(2,500)
(ii) UK tax = (£2,561 + £6,659) = £9,220			
			<u>8,206</u>
Income tax liability			

Note:

The dividend nil rate band is available and dividends falling into the higher rate band are taxed at 33.75% (not 40%) as Hussein is taxed on an arising basis.

Hussein could not be taxed on the remittance basis as he is domiciled in the UK.

**Illustration 4 – Double tax relief**

Jeffrey has the following income:

	£	Overseas tax suffered
Trading profits – UK	46,340	
Overseas rental income (1) (gross)	1,500	26%
Overseas rental income (2) (gross)	3,000	23%
	<u>50,840</u>	
Total income	50,840	
Less: PA	(12,570)	
	<u>38,270</u>	
Taxable income	38,270	

Analysis of income:

Non-savings income = £38,270

Income tax liability (before DTR) is:

	£		£
Non-savings income	37,700	× 20%	7,540
Non-savings income	570	× 40%	228
	<hr/>		
	38,270		
	<hr/>		
Income tax liability (before DTR)			<hr/> 7,768 <hr/>

Advise how much DTR is available on each source of overseas income.

Solution

The overseas rental income is charged in the UK partly at 40% and partly at 20%. To obtain the maximum DTR, the income suffering the highest overseas rate of tax is considered first.

Overseas source (1) has the highest overseas tax rate, so the DTR on that source of income will be:

		£	£
(i)	Overseas tax paid (£1,500 × 26%)		390
(ii)	UK tax on the overseas income		
	570 (top slice) @ 40%	228	
	930 @ 20%	186	
	<hr/>		
	1,500		<hr/> 414 <hr/>

DTR = lower amount = £390 (i.e. full credit for overseas tax paid)

The DTR on overseas source (2) will then be:

	£
(i)	Overseas tax paid (£3,000 × 23%) 690
(ii)	UK tax on overseas income (£3,000 × 20%) 600

DTR = lower amount = £600

Note: The unrelieved overseas tax of £90 on overseas source (2) is lost.



Test your understanding 8

Benny is UK domiciled and resident in the UK and has the following income taxable in the tax year 2023/24.

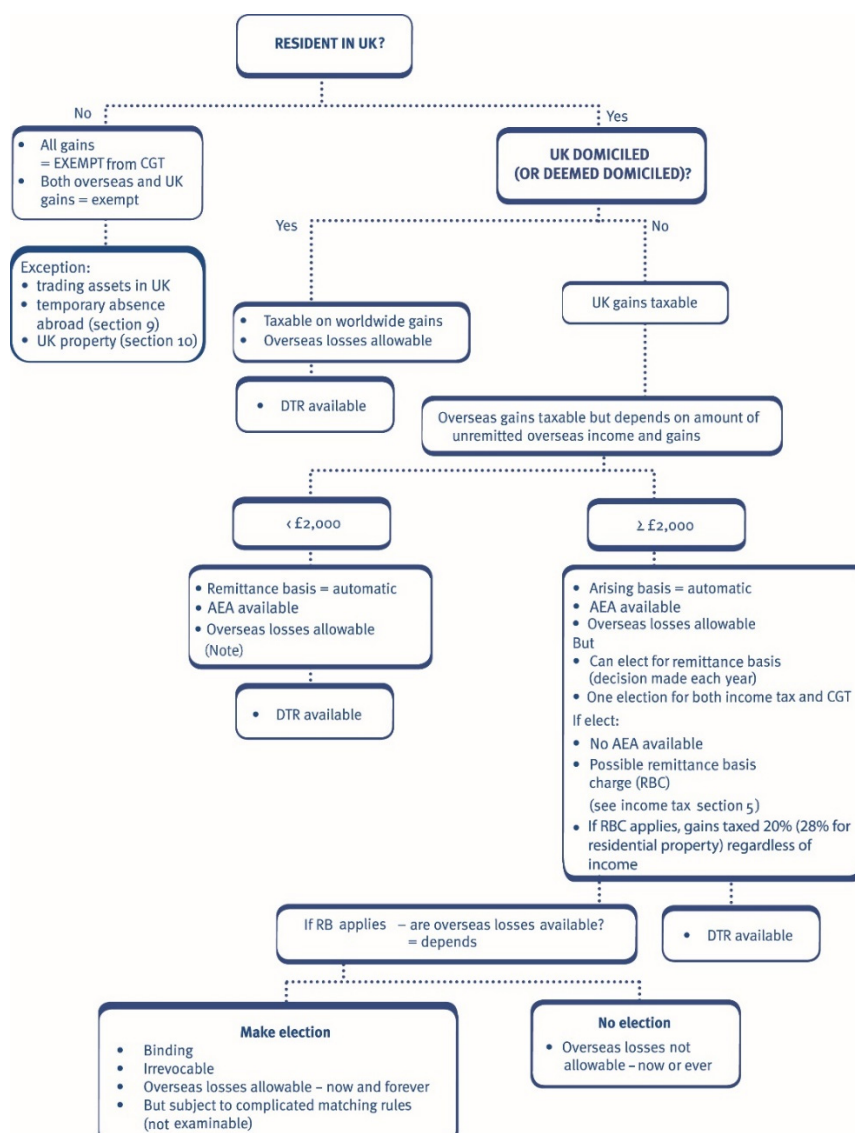
	£	
Trading profits – UK	37,990	
UK bank interest	3,085	
Utopian bank interest (50% Utopian tax paid)	1,100	(gross)
Ruritanian rent (15% Ruritanian tax paid)	600	(gross)

Calculate the income tax payable or repayable considering all available reliefs.



7 Overseas aspects of capital gains tax

As for income tax, the tax status of an individual is important in determining the gains on which they are taxed. The consequences of an individual's status are:



Notes:

- The remittance basis will still be automatically available for deemed domiciled individuals if their unremitted overseas income and gains are under £2,000.
- The individual will need to consider the remittance basis election each year separately as a large overseas gain in a year may make the remittance basis claim worthwhile in that year but not in others – but remember the election applies to both income and gains in that year.
- The capital loss election is a one-off election that had to be made the first time the individual elected for the remittance basis to apply whether or not the taxpayer had any capital losses at that time. If the election is not made then foreign capital losses may not be used whilst the individual is still not UK domiciled.

As the capital loss election is binding, and the remittance basis election will probably have been claimed in the past by the taxpayer, in the examination question you need to find out whether or not the capital election was made at that time.

- Where proceeds from the sale of an overseas capital asset are remitted to the UK, that amount of the capital gain is deemed to be remitted first (not a proportion of the gain).

Exceptions to the exemption from CGT for non-UK residents

All gains (both UK and overseas gains) of an individual who is NR in the UK are exempt, except in three key circumstances:

- in the rare situation where the individual operates a trade, profession or vocation through a permanent establishment in the UK and disposes of an asset from the business
- where the temporary absence abroad conditions are satisfied (see section 9)
- where the individual disposes of UK property (see section 10).



Illustration 5 – Overseas aspects of capital gains tax

Andreas sold his shares in a Spanish manufacturing company for £500,000 on 16 February 2024. The holding represents a 1% shareholding. Half of the proceeds were paid into his Spanish bank account and the other half into his UK bank account.

The gain on the disposal is £278,850. Andreas purchased the shares in August 2005.

Explain the CGT position assuming Andreas is:

- (a) **UK resident and domiciled in the UK**
- (b) **UK resident for the previous 5 tax years but not UK domiciled and elected for the remittance basis**
- (c) **UK resident for the previous 10 years but not UK domiciled and elected for the remittance basis**
- (d) **not UK resident but UK domiciled.**

Solution

- (a) **UK resident and domiciled in the UK**

Andreas is liable to CGT on gains arising on his worldwide assets, regardless of whether or not the proceeds are remitted to the UK.

Chargeable gain	£278,850

The AEA is fully available. The gain will be taxed at 10% or 20% depending on the level of Andreas' income. BADR is not available as his shareholding is less than 5%.

- (b) **UK resident for 5 tax years but not UK domiciled**

Andreas is liable to CGT on gains arising on his overseas assets only to the extent that the proceeds are remitted to the UK as he has elected for the remittance basis.

As £250,000 ($£500,000 \div 2$) of the proceeds are remitted to the UK, this is deemed to be £250,000 worth of chargeable gain and will be taxed on Andreas in the tax year 2023/24.

Chargeable gain	£250,000

No AEA is available.

Part of this gain may be taxed at 10% if Andreas has any basic rate band remaining after taxing his income. The remaining gain of £28,850 ($£278,850 - £250,000$) will be taxed when more of the proceeds are remitted.

- (c) **UK resident for 10 tax years but not UK domiciled**

Andreas is liable to CGT on gains arising on his overseas assets only to the extent they are remitted to the UK as he has elected for the remittance basis.

However, as he has been resident for 7 out of the last 9 tax years immediately preceding the current tax year, a £30,000 tax charge is payable.

This charge will be added to his CGT or income tax liability depending on whether Andreas nominates income or gains to be covered by the charge.

In addition, as half of the proceeds are remitted to the UK, £250,000 of the gain will be taxed in the tax year 2023/24.

No AEA is available.

All of this gain will be taxed at 20% regardless of the level of Andreas' taxable income.

(d) **Not UK resident but UK domiciled**

Andreas is exempt from CGT on both overseas and UK gains.

There are exceptions to this rule:

- Andreas would be subject to CGT if he disposes of an asset which is used in carrying on a trade, profession or vocation, through a permanent establishment in the UK.
- Andreas is only temporarily absent abroad (section 9)
- the asset is a UK property (section 10).



Test your understanding 9

Cecilia is domiciled in Austria, but has been resident in the UK for the last four years. For the tax years 2020/21 and 2021/22 she elected for the remittance basis to apply to her income and gains, but made no election in respect of capital losses as she did not have any in either of those tax years. Cecilia is a higher rate taxpayer.

In the tax year 2023/24, she sells the following assets:

- (1) An asset in Austria for £220,000 and realised a capital gain of £55,000. She remitted £50,000 of the proceeds into the UK.
- (2) An asset in Hungary for £80,000 and realised a capital loss of £35,000.
- (3) A UK asset for £49,500 and realised a capital gain of £25,350.
- (4) UK quoted shares for £30,100 and realised a capital loss of £18,000.

None of the assets disposed of are residential property.

Calculate Cecilia's CGT liability, assuming:

- (a) **She does not claim the remittance basis for the tax year 2023/24**
- (b) **She claims the remittance basis for the tax year 2023/24.**



8 Double taxation relief – capital gains tax

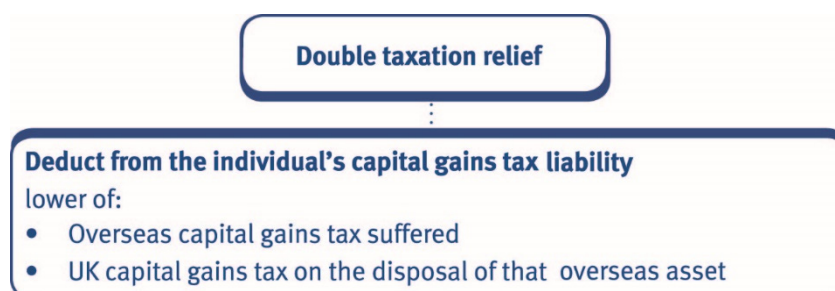
As seen in section 7, an individual who is:

- Resident in the UK and is domiciled or deemed domiciled in the UK
= taxed in the UK on worldwide gains (UK and overseas gains)
- Resident in the UK, but is non-UK domiciled
= taxed in the UK on overseas gains on either an arising or remittance basis, and on UK gains

However, the overseas gains may also be taxed overseas.

Double taxation relief (DTR) is available as follows:

- under a bilateral double taxation treaty agreement between the UK and the overseas country, or
- unilaterally as a tax credit relief.



When calculating the UK tax on overseas gains:

- the AEA is allocated against UK gains first
- the overseas gains are treated as the 'top slice' of taxable gains, giving the highest UK tax possible and maximising the DTR.



Illustration 6 – Double taxation relief

Julie is resident and domiciled in the UK. In December 2023 she sells assets which give rise to the following chargeable gains:

UK asset	£22,000
Overseas asset	£66,000

Overseas capital taxes of £14,000 are payable on the disposal of the overseas asset.

None of the assets disposed of are residential property.

Calculate Julie's CGT liability for the tax year 2023/24, assuming she is a higher rate taxpayer.

Solution

	£
UK asset	22,000
Overseas asset	66,000
	<hr/>
Total chargeable gain	88,000
Less: AEA	(6,000)
	<hr/>
Taxable gain	82,000
	<hr/>
CGT liability ($£82,000 \times 20\%$)	16,400
Less: DTR (W)	(13,200)
	<hr/>
CGT payable	3,200
	<hr/>

Working: DTR

	£
Lower of	
(i) Overseas tax suffered (given)	14,000
(ii) UK tax on overseas gain:	
Overseas gain ($£66,000 \times 20\%$)	13,200
(AEA set against UK gain)	

**Test your understanding 10**

Diane is UK resident and domiciled in the UK. She disposed of the following assets in the tax year 2023/24:

- (a) A UK asset was sold on 8 July 2023 giving rise to a gain of £22,000.
- (b) An overseas investment asset was sold on 14 September 2023 giving rise to a gain of £12,760. Overseas CGT payable was £3,850.
- (c) A UK asset was sold on 29 October 2023 giving rise to a gain of £29,000.

Diane has taxable income for the tax year 2023/24 of £70,000.

None of the assets disposed of are residential property.

Calculate Diane's capital gains tax payable for the tax year 2023/24.



9 Temporary absence abroad

As for income tax, for capital gains tax, an individual's tax status normally applies for whole tax years.

However, the split year basis applies to capital gains tax in the same way as income tax (section 2).

For periods where an individual is not UK resident, the individual is effectively exempt from UK CGT on worldwide gains (UK and overseas), apart from some exceptions.

However, to counter abuse of this rule, special rules apply for temporary absences abroad.

Special rules

When an individual returns to the UK after a period of 'temporary non-UK residence', the individual will be **charged to tax on gains arising in that period of temporary non-UK residence** (i.e. the exemption from CGT does not apply) if conditions are satisfied.



Definition of 'temporary non-UK residence'

An individual will be regarded as temporarily non-UK resident if:

- in **four** or more of the **seven tax years** immediately **preceding the tax year of departure** the individual was UK resident, and
- the **period of non-UK residence** is **five years or less**.

The way in which the capital gains are taxed is as follows:

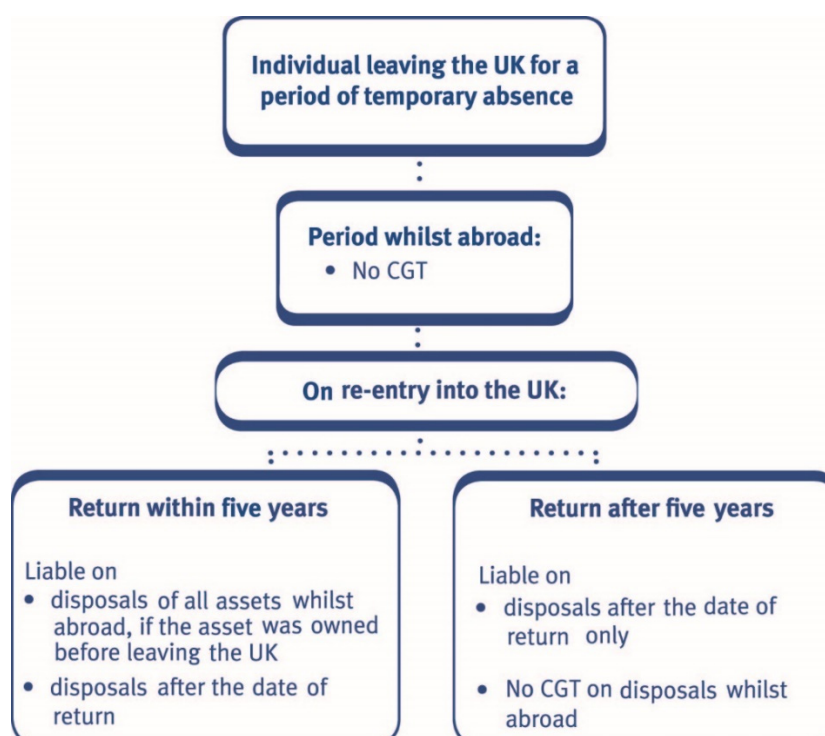




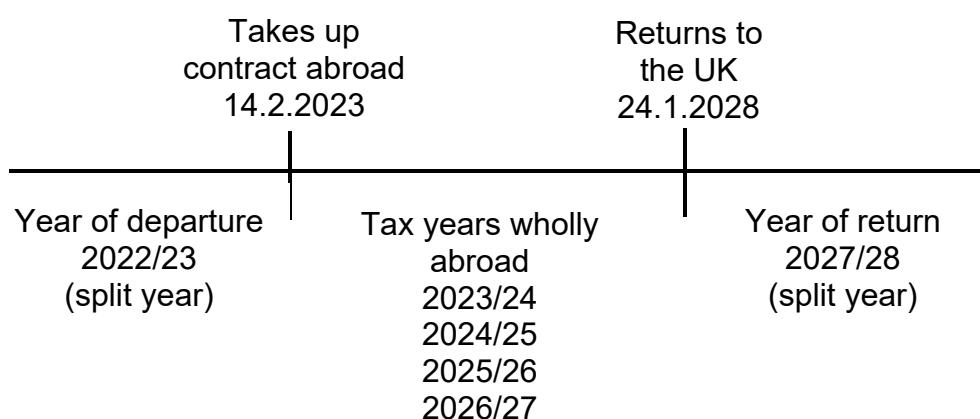
Illustration 7 – Temporary absence abroad

Joanna takes up a full-time contract working abroad on 14 February 2023 and returns to the UK on 24 January 2028.

Assume that the split year basis applies in the tax year of departure and return.

As Joanna is abroad for less than five years, the gains arising whilst abroad are subject to CGT.

The way in which the gains are taxed is as follows:



Tax year of departure (2022/23)	Tax years wholly abroad (2023/24 to 2026/27)	Tax year of return (within 5 years) (2027/28)
Liable on <ul style="list-style-type: none"> disposals before the date of departure 	No CGT on any disposals whilst abroad except on UK property and/or assets held by a UK PE that she trades through.	Liable on <ul style="list-style-type: none"> all disposals of assets whilst abroad if the assets were owned by the individual before leaving the UK (known as a 're-entry charge') any disposals made after the date of return

Note that

- Assets that Joanna **acquired after leaving the UK** which she then sells whilst abroad are not liable to UK capital gains tax.
- In this example, if Joanna had stayed abroad for a further 22 days, she would be exempt from CGT on all disposals whilst abroad. This is because the period of absence from the UK would have spanned over five years (14 February 2023 to 15 February 2028).



Illustration 8 – Temporary absence abroad

June has lived in the UK all her life and is planning to emigrate to Australia. On 31 December 2023, she will sell her UK home and plans to leave the UK on 6 January 2024.

Her home which is currently valued at £200,000 will give rise to a gain of £20,000.

She owns the following UK assets:

- (1) 10,000 shares in Kestrel plc (a manufacturing company) which she acquired for £6 each one year ago. The shares have a current value of £100,000 and if all of the shares were sold, a capital gain of £40,000 would arise.
- (2) A painting which is worth £80,000. If it is sold it will crystallise an allowable loss of £10,000.

June wishes to sell as many assets as possible before she emigrates, but does not want to pay any capital gains tax.

Assume today's date is 10 December 2023 and that June has asked you for some advice.

- (a) **Advise June of the assets she should sell before leaving the UK.**
- (b) **Explain the consequences of selling the shares in Kestrel plc while she is abroad if:**
 - (i) **she ceases to have a home in Australia, returns to the UK and acquires a UK home on 31 December 2027 as she is homesick**
 - (ii) **she ceases to have a home in Australia, returns to the UK and acquires a UK home on 31 December 2031 as she is homesick.**

Solution

- (a) **Disposal of assets before leaving the UK**

Asset	Sell?	Reason
Home	Yes	An individual's private residence is exempt from CGT (see Note)
Painting	Yes	This is the disposal of a chargeable asset which generates an allowable capital loss of £10,000
Kestrel plc shares	Yes, but only some of the shares	June should dispose of sufficient shares to realise a gain of £16,000 (£10,000 + £6,000) which is covered by the allowable capital loss and her AEA. Therefore, June should dispose of 4,000 shares (see working below)

Note:

The sale of the UK home will trigger the split year in the tax year 2023/24 and the end of the UK part of that tax year. The period of temporary absence therefore starts on 1 January 2024.

Working: Optimum number of Kestrel plc shares to sell

	£
Sale proceeds for each share	10
Less: Cost of each share	(6)
	—
Chargeable gain realised on disposal of each share	4
	—

Therefore, to crystallise a chargeable gain of £16,000, June should dispose of 4,000 shares (£16,000 ÷ £4).

(b) Consequences of selling the remaining shares whilst abroad

	(i)	(ii)
End of UK residence	31 December 2023	31 December 2023
Start of UK residence	1 January 2028 = four years	1 January 2032 = eight years
CGT on disposals of chargeable assets made while June is in Australia	As June is in Australia for less than five years, any gains made while in Australia will be subject to CGT in the tax year she returns to UK (2027/28)	As June is in Australia for more than five years, no CGT is payable on disposals made while she is in Australia

**Test your understanding 11**

Yolanda, a UK national, has lived in the UK since birth. On 15 July 2023 she took up a full-time contract of employment in Columbia. She will not return to the UK during the contract period but will return to the UK at the end of the contract on 24 October 2026.

Her disposals during this period were as follows:

Asset	Date of purchase	Date of sale	Gain £
1	3 Sept 2006	17 July 2024	125,896
2	9 July 2018	18 Oct 2025	5,024
3	12 Aug 2023	27 Feb 2026	78,400

None of these assets were UK properties.

Explain which disposals will be chargeable and when any gains arising as a result of the disposals will be taxed.



10 Non-UK residents and UK property disposals

Non-UK residents are normally exempt from CGT on all asset disposals. However, non-UK resident individuals and companies disposing of UK property may be liable to tax (CGT or corporation tax), subject to special rules.

The ACCA have stated that they will only examine these special rules in the context of a non-UK resident individual (not a company).

Non-UK resident individuals are subject to CGT on:

- disposals of **UK residential property** after **5 April 2015**
- disposals of **UK non-residential property** after **5 April 2019**

For exam purposes, properties will either be wholly residential or wholly non-residential throughout ownership. You will not have to deal with mixed use properties.

Disposals of UK residential property

The disposal of a UK residential property by a non-UK resident individual: is a chargeable disposal, and

- a liability to CGT will arise, but
- only on **gains accruing after 5 April 2015**
- to the extent that they are not covered by
 - reliefs (e.g. PRR, rollover relief or gift holdover relief), or
 - the AEA.

Any **taxable gain** will be taxed according to the level of the individual's **UK taxable income** and consequential remaining basic rate band in the normal way.

Calculation of the gain or loss

If the UK residential property is purchased after 5 April 2015, the gain (or loss) before considering reliefs is calculated in the normal way.



In the ATX exam you will **only** have to deal with a UK property acquired **after 5 April 2015**.

If the property was purchased before 5 April 2015, special rules apply, but these rules are **not examinable**.

Disposals of UK non-residential property

From 5 April 2019 non-UK resident individuals are also subject to CGT on disposals of UK non-residential property. The purpose of the new rule is to align the UK with other countries and remove the advantage non-UK resident individuals previously had over UK resident individuals.

Methods of calculating the gain or loss

If the UK property was purchased after 5 April 2019, the gain (or loss) before considering reliefs is calculated in the normal way.

If the asset was purchased before 5 April 2019, there are two methods of calculating the gain accruing since 5 April 2019 before the consideration of reliefs:

- (1) rebasing the cost to market value at 5 April 2019 (automatic treatment without an election), or
- (2) electing for the whole gain or loss (i.e. ignoring rebasing and using the original cost).



Test your understanding 12

Jim is domiciled in the UK and was UK resident until January 2018 when he emigrated to Portugal.

He purchased an office in the UK as an investment on 4 October 2017 for £420,000. He has rented it out to tenants for the entire period of ownership.

On 6 June 2029 he plans to sell the office and hopes to receive sale proceeds of £780,000. The market value of the office on 5 April 2019 was £545,000.

- (a) **Calculate the gain arising on Jim (before considering reliefs) in the tax year 2029/30 assuming:**
 - (i) **the gain is calculated using the automatic rebasing method**
 - (ii) **the election for the whole gain is made.**
- (b) **Calculate the allowable loss if the office is sold for £400,000 and had a market value on 5 April 2019 of £410,000, assuming:**
 - (i) **the loss is calculated using the automatic rebasing method**
 - (ii) **the election for the whole loss is made.**

Assume that the 2023/24 rates and allowances apply throughout.

Interaction with temporary non-UK residence rules

If an individual who is temporarily non-UK resident disposes of a UK property then both the temporary non-UK residence rules and the non-UK resident CGT rules can apply to the same disposal.

In this case, when the UK property is disposed of during the period of non-UK residence, only the gain arising post 5 April 2015/2019 (depending on the type of property) is chargeable to CGT at that time.

If the individual returns to the UK within five years and becomes UK resident, the rest of the gain becomes chargeable on the individual's return (i.e. the difference between what would have been charged if the individual had been UK resident at the time of disposal and the actual amount that was charged whilst the individual was non-UK resident).

Availability of CGT reliefs

There are three reliefs to consider in respect of the disposal of a UK property, each with special rules when applied to the disposal by a non-UK resident individual:

(1) PRR

If the property has at some time been the individual's private residence, PRR is available but is restricted and is subject to conditions (see below).

(2) Rollover relief

If the UK property is a business asset (e.g. furnished holiday lettings) and is sold, rollover relief may be available but only if the replacement asset purchased is UK land and buildings used in a trade, not any other type of qualifying asset (e.g. fixed plant and machinery).

(3) Gift holdover relief

Gift holdover relief is normally only available on gifts of business assets by an individual to another individual, trustee or company that is **resident in the UK** at the time of the gift.

However, if the gift is

- UK property
- which is a business asset (e.g. furnished holiday lettings), and
- it is gifted to a **non-UK resident** individual; trustee or company gift holdover relief is available.

PRR for non-UK resident individuals

PRR will be available as usual (see Chapter 9) for periods when the individual occupied the property as the main residence.

However, non-UK resident individuals will only qualify for PRR on UK residential property in a tax year if they (or their spouse or civil partner):

- were resident in the UK for that tax year, or
- stayed in the property for a total of at least 90 nights in the tax year (the 90-day rule).

The 90-day rule is time apportioned if the property was not owned for the whole tax year.

The normal definition of periods of occupation and non-occupation and availability of letting relief is basically unchanged, except that for periods of non-occupation:

- if the 90-day rule above is not satisfied, the whole tax year is treated as a period of non-occupation for PRR purposes (i.e. any actual occupation during that tax year is ignored).

Provided the property qualified as the individual's private residence at some time during the period of ownership, PRR will be available for the last nine months of ownership as for UK residents.



Test your understanding 13

Erin is domiciled in the UK and was UK resident throughout her life until 2019.

She purchased her home in the UK on 30 September 2017 for £450,000. She lived there until she retired on 5 April 2019 and went to live permanently in Australia. Since retiring she has rented the UK property.

Erin returns to the UK for a maximum of three weeks each year.

On 31 March 2025 she plans to sell the UK property and expects to receive sale proceeds of £600,000.

Calculate the taxable gain arising on Erin in the tax year 2024/25.

Assume the 2023/24 rates and allowances apply.

UK resident individuals with a residential property outside the UK

With effect from 6 April 2015, UK resident individuals with residential property outside the UK will qualify for PRR on that property in a tax year if they (or their spouse or civil partner):

- were resident in the overseas country for that tax year, or
- stayed in that property for a total of at least 90 nights in the tax year.

Allowable losses for non-residents

Any losses arising on UK property made by a non-resident individual (residential or non-residential) are 'ring fenced' and can only be set against:

- gains from other UK property disposals in the same year, then
- carried forward against future UK property gains.

If the individual changes tax status and subsequently becomes UK resident:

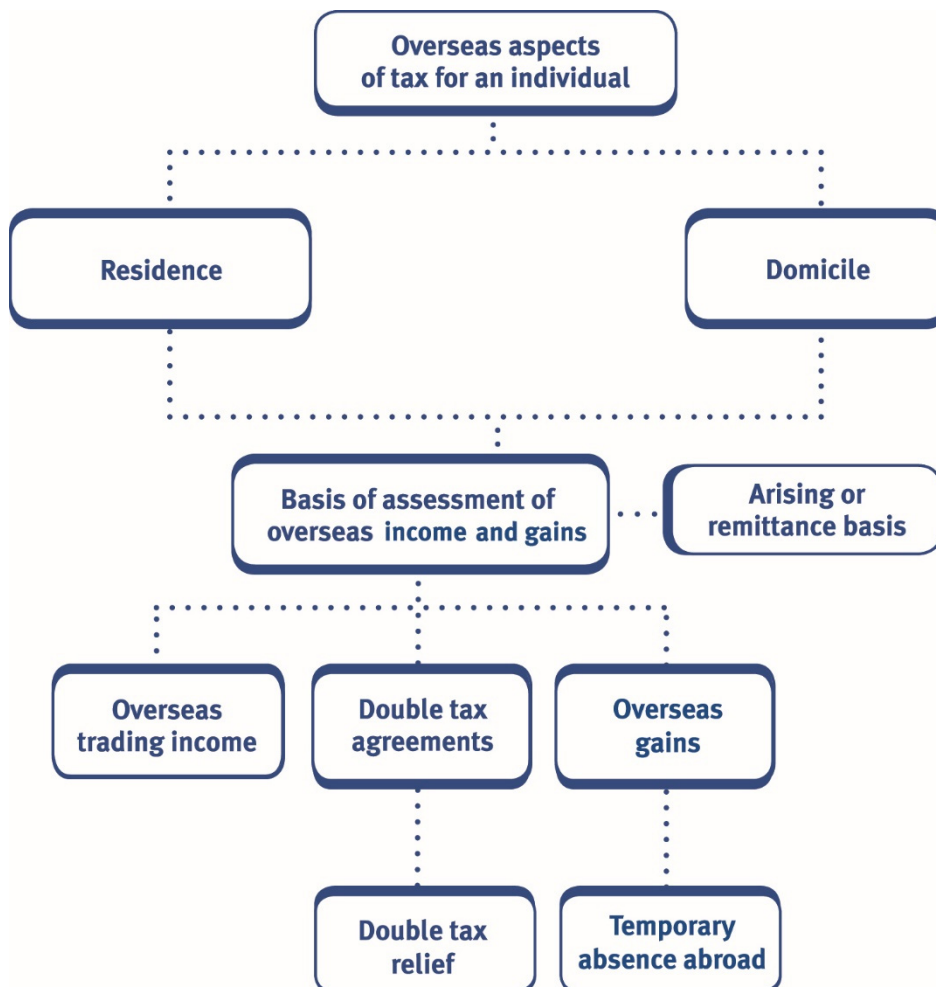
- the unused losses will no longer be 'ring-fenced'
- they will become normal capital losses, and
- can be set against other chargeable gains.

**Reporting disposals**

HMRC must be notified of the disposal of any UK property by a non-UK resident individual within 60 days of the conveyance of the property, even if there is no CGT liability. If several disposals are made, each one should be reported separately.

Penalties will apply for late reporting, inaccurate returns and late payment as usual.

11 Chapter summary



Test your understanding answers



Test your understanding 1

Residency

- (i) Jean-Paul has been in the UK for 220 days in the tax year 2023/24.
- Step 1: He does not satisfy the automatic non-UK residence tests as he is in the UK > 90 days.
- Step 2: He does satisfy the automatic UK residence tests as he is in the UK > 183 days.
- Accordingly, he will automatically be treated as UK resident in the tax year 2023/24.
- (ii) Carmen has been in the UK for 31 days (maximum)
- Step 1 As she has not been resident in the UK in any of the three previous tax years, and has been in the UK for less than 46 days, she will automatically be treated as not UK resident in the tax year 2023/24.
- (iii) Khalil spent 25 days in the UK in the tax year 2023/24:
- Step 1 He has spent too many days in the UK to be automatically not resident (i.e. > 16 days as previously resident in UK).
- Step 2: He is not automatically resident as he has not been in the UK for sufficient days, has an overseas home and has not had full time work in the UK during the tax year 2023/24.
- Step 3: Sufficient ties tests
- Khalil has been UK resident during the three previous tax years.
- He was in the UK in the tax year 2023/24 for between 16 and 45 days and must therefore meet at least four of the UK ties tests to be deemed UK resident.
- Khalil meets the:
- days in UK tie (spent more than 90 days in UK in both of previous two tax years) only.

He does not meet the other ties as:

- he does not have a spouse or civil partner or minor children that are UK resident
- he does not have a house in the UK which was available for at least 91 days during the tax year
- does not work in the UK in the tax year 2023/24, and
- he spends three months (92 days) in Florida and therefore spends more time in USA than he does in the UK in the tax year 2023/24.

As he only satisfies one sufficient ties test, not four, he is not UK resident in the tax year 2023/24.

(iv) Bruce spent 128 days in the UK in the tax year 2023/24.

Step 1: Bruce has spent too many days in the UK in the tax year 2023/24 to be automatically considered non-UK resident (i.e. > 90 days).

Step 2: He has not spent sufficient days in the UK (i.e. < 183 days) and has accommodation in Australia therefore he is not automatically UK resident.

Step 3: Sufficient ties tests.

Bruce has not been UK resident in any of the previous three tax years.

As he has spent between 121 and 182 days in the UK in the tax year 2023/24 he must have two UK ties to be considered UK resident, and only the first four ties are considered.

Bruce meets the:

- accommodation tie (made use of a UK house) only.

He does not meet the other ties as:

- he does not have a spouse or civil partner or minor children that are UK resident
- he does not do substantive work in the UK tie (works less than 40 days)
- he has not spent more than 90 days in UK in either of previous two tax years.

As he meets only one UK tie he will be treated as not UK resident in the tax year 2023/24.



Test your understanding 2

Helen

Helen will be taxed on a split year basis for the tax year 2023/24 because:

- she was UK resident in the tax years 2022/23 and 2023/24 as she was in the UK for at least 183 days
- she is not UK resident for the tax year 2024/25
- she leaves the UK during the tax year 2023/24 to begin working abroad
- from 1 November 2023 until 5 April 2024 she:
 - works full time in Dubai
 - spends only 14 days in the UK, which is less than the permitted number of days.

For the tax year 2023/24, the year will be split as follows:

- UK part = 6 April 2023 to 31 October 2023
- Overseas part = 1 November 2023 to 5 April 2024.



Test your understanding 3

Bjorn

Bjorn will be taxed on a split year basis for the tax year 2023/24 because:

- he is not UK resident for the tax year 2022/23
- he is resident for the tax year 2023/24 as he is in the UK for at least 183 days
- he acquired a home in the UK during the tax year and stayed there for the rest of the tax year
- he had no UK ties until acquiring his UK home on 1 August 2023.

For the tax year 2023/24, the year will be split as follows:

- Overseas part = 6 April 2023 to 31 July 2023
- UK part = 1 August 2023 to 5 April 2024.

Note that Bjorn will also satisfy the conditions for split year basis as he begins 'working full time in the UK' – however under these rules his 'overseas part' will not end until 21 August 2023. However, where more than one of the situations applies, priority is given to the one that gives the shortest 'overseas part'.



Test your understanding 4

Helen

(a) Reason for split year basis

Helen will be taxed on a split year basis for the tax year 2025/26 because:

- she is not UK resident for the tax year 2024/25
- she is UK resident for the tax year 2025/26 (as she carries out full time work in the UK during a 365-day period, some of which falls within the tax year)
- she ceases working abroad and returns to the UK, having worked full time overseas
- she is resident in the UK in the following tax year (2026/27).

For 2025/26, the year will be split as follows:

- Overseas part = 6 April 2025 to 30 November 2025
- UK part = 1 December 2025 to 5 April 2026.

(b) Basis of assessment whilst in Dubai

Tax year	Status	Basis of assessment
2023/24	Split year basis applies: R and D in UK up to 31 October 2023 (7 months) NR but D in UK for overseas part from 1 November 2023 (5 months)	Worldwide income = taxable on an arising basis All UK income = taxable on an arising basis Overseas income = exempt
2024/25	NR but D in UK for whole tax year	All UK income = taxable on an arising basis Overseas income = exempt
2025/26	Split year basis applies: NR but D in UK for overseas part up to 30 November 2025 (8 months) R and D in UK for UK part from 1 December 2025 (4 months)	All UK income = taxable on an arising basis Overseas income = exempt Worldwide income = taxable on an arising basis

Helen's taxable property income

	2023/24	2024/25	2025/26
	£	£	£
UK property income ($5/12 \times £15,000$)/full/($8/12 \times £15,000$)	6,250	15,000	10,000
Overseas property income ($7/12 \times £12,000$)/(4/12 \times £12,000)	7,000	0	4,000
	<hr/>	<hr/>	<hr/>
Total taxable property income	13,250	15,000	14,000
	<hr/>	<hr/>	<hr/>

(c) Helen's taxable property income

	2023/24	2024/25	2025/26
	£	£	£
UK property income (Note)	6,250	15,000	10,000
Overseas property income	12,000	0	12,000
	<hr/>	<hr/>	<hr/>
Total taxable property income	18,250	15,000	22,000
	<hr/>	<hr/>	<hr/>

Note: Helen's home is only rented when she is abroad and the income is UK income. Therefore, it is always all taxable, but needs time apportioning in the tax years 2023/24 and 2025/26 because it is not rented for the whole of those years.



Test your understanding 5

Ewa

Unremitted overseas income in the tax year 2023/24 is £3,000 which is \geq £2,000.

Therefore the arising basis will apply automatically and the personal allowance is available.

However, Ewa can elect for the remittance basis (RB) to apply. If the election is made, personal allowances will not be available.

Income tax computation – 2023/24

	No RB election £	With RB election £
Trading profits – UK	25,000	25,000
Overseas property income (gross)	3,000	0
Total income	28,000	25,000
Less: PA	(12,570)	(0)
Taxable income	15,430	25,000
Income tax liability \times 20%	3,086	5,000

Conclusion: Ewa should not claim the remittance basis in the tax year 2023/24.



Test your understanding 6

Remittance basis charge

	Ivor	Sasha	Juan	Pierre
RBC	None	£60,000	£30,000	None

Note: Ivor has been in the UK for < 7 years so is not liable to the RBC. Sasha has been in the UK for 12 out of the last 14 tax years.

Juan has been in the UK for 7 out of the last 9 tax years, but not 12 out of the last 14 tax years.

As Pierre has been UK resident for 15 out of the last 20 tax years, he will be deemed to be UK domiciled. However, as his unremitted income and gains amount to less than £2,000, he is still automatically taxed on the remittance basis and is not liable to the RBC. If his unremitted income and gains amounted to £2,000 or more, he would no longer be able to use the remittance basis.



Test your understanding 7

Gita

Income tax computation – 2023/24

				No RB election £	With RB election £
Trading profits – UK				90,000	90,000
Overseas interest (gross)				63,000	10,000
Overseas rent (gross)				95,000	0
				<hr/>	<hr/>
Total income				248,000	100,000
Less: PA (Notes 1 and 2)				(0)	(0)
				<hr/>	<hr/>
Taxable income				248,000	100,000
				<hr/>	<hr/>
Income tax	£	£			
Non-savings	37,700	37,700	× 20%	7,540	7,540
Non-savings	87,440	62,300	× 40%	34,976	24,920
Non-savings	59,860		× 45%	26,937	
Savings	63,000		× 45%	28,350	0
	<hr/>	<hr/>		<hr/>	<hr/>
	248,000	100,000		97,803	32,460
	<hr/>	<hr/>		<hr/>	<hr/>
Plus: RBC (Note 3)				0	60,000
				<hr/>	<hr/>
Income tax liability				97,803	92,460
				<hr/>	<hr/>

Gita would be better off if she elects for the remittance basis to apply. The decision re-the remittance basis is made each year.

Notes:

- (1) Under the arising basis, the PA is not available as adjusted net income is > £125,140.
- (2) Under the remittance basis, the PA is not available.
- (3) The remittance basis charge is £60,000 as Gita has been UK resident for 12 of the last 14 tax years.
- (4) Without a remittance basis election, the savings income nil rate band (SNRB) is not available as Gita is an additional rate taxpayer. With a remittance basis claim, Gita becomes a higher rate taxpayer. However, the SNRB is still not available as all income is taxed at non-savings rates if the remittance basis is claimed.



Test your understanding 8

Benny

Income tax computation – 2023/24

	£
Trading profit – UK	37,990
Ruritanian rent	600
Utopian bank interest	1,100
Bank interest	3,085
	<hr/>
Total income	42,775
Less: PA	(12,570)
	<hr/>
Taxable income	30,205
	<hr/>

Analysis of income:

Savings

£4,185

Non-savings income

(£30,205 – £4,185) = £26,020

Income tax:

	£		£
Non-savings income	26,020	× 20%	5,204
SNRB	1,000	× 0%	0
Savings income	3,185	× 20%	637
	<hr/>		
	30,205		
	<hr/>		
			5,841
			<hr/>
Less: DTR – Utopian tax (W1)			(220)
– Ruritanian tax (W2)			(90)
			<hr/>
Income tax liability = income tax payable			5,531
			<hr/>

Workings**(W1) DTR on Utopian income**

The Utopian income has suffered the higher rate of overseas tax and therefore relief is calculated in respect of this source of income first.

DTR = lower of

	£	£
(a) UK tax = £1,100 × 20%	220	
(b) Overseas tax = (50% × £1,100)		550

(W2) DTR on Ruritanian income

	£
DTR = lower of	
(a) UK tax (20% × £600)	120
(b) Overseas tax = (15% × £600)	90

**Test your understanding 9****Cecilia****Capital gains tax computation – 2023/24**

	(a) No RB election £	(b) With RB election £
Asset in Austria	55,000	50,000
Asset in Hungary	0	0
UK asset	25,350	25,350
UK quoted shares	(18,000)	(18,000)
	<hr/>	<hr/>
Total chargeable gains	62,350	57,350
Less: AEA	(6,000)	(0)
	<hr/>	<hr/>
Taxable gains	56,350	57,350
	<hr/>	<hr/>
Capital gains tax		
£56,350/£57,350 × 20%	11,270	11,470
	<hr/>	<hr/>

Cecilia would be better off if she does not elect for remittance basis to apply in the tax year 2023/24.

Notes:

- The decision re-the remittance basis is made each year.
- The decision re-the use of overseas losses must be made the first time the remittance basis is claimed, even if there are no overseas losses in that year, and the decision is irrevocable and binding on subsequent years.

**Test your understanding 10****Diane****Capital gains tax computation – 2023/24**

	£
UK asset	22,000
Overseas asset	12,760
UK asset	29,000
	<hr/>
Total chargeable gains	63,760
Less: AEA	(6,000)
	<hr/>
Taxable gains	57,760
	<hr/>
Capital gains tax (£57,760 × 20%)	11,552
Less DTR	
Lower of	
(i) Overseas CGT suffered	£3,850
(ii) UK CGT applicable to overseas asset (W)	£2,552
	(2,552)
	<hr/>
CGT payable	9,000
	<hr/>

Note: As Diane is UK resident and domiciled in the UK, she is liable on her worldwide asset gains on an arising basis. Full AEA is available. DTR is available.

Working: UK CGT on overseas asset

Overseas gain (Note) (£12,760 × 20%) = £2,552

Note: The AEA is set against the UK gains.



Test your understanding 11

Yolanda

End of UK residence:	15 July 2023
Start of UK residence:	24 October 2026
Years abroad:	three years

Chargeable whilst abroad:

There is no CGT liability arising in the years whilst Yolanda is abroad.

However, the gains arising on the disposal of assets owned by Yolanda on 15 July 2023 become chargeable when she re-enters the UK in the tax year 2026/27.

Chargeable in the year of return to the UK: 2026/27

Assets 1 and 2: These assets were owned by Yolanda before she went abroad, therefore chargeable on return.

	£
Chargeable gain – Asset 1	125,896
Chargeable gain – Asset 2	5,024
	<hr/>
	130,920
	<hr/>

Asset 3: There is no CGT liability arising on the disposal of Asset 3 as the asset was not owned by Yolanda before she went abroad on 15 July 2023, and it was sold before she returned.



Test your understanding 12

(a) Jim

Chargeable gain before considering reliefs – 2029/30

At the time of disposal Jim is not resident in the UK and would normally be exempt on any gains arising in the UK and overseas. However, as he is disposing of UK property, a chargeable gain will arise as follows:

	(i) Rebasing to 5 April 2019 £	(ii) Whole period £
Sale proceeds	780,000	780,000
Less: MV at 5 April 2019/Cost	(545,000)	(420,000)
Capital gain	235,000	360,000
Chargeable gain before considering reliefs	235,000	360,000

Jim would not elect for the whole period basis to be applied.

(b) Jim

Allowable loss – 2029/30

If the property is sold for £400,000, an allowable loss would arise as follows:

	(i) Rebasing to 5 April 2019 £	(ii) Whole period £
Sale proceeds	400,000	400,000
Less: MV at 5 April 2019/Cost	(410,000)	(420,000)
Allowable loss	(10,000)	(20,000)

Jim would elect for whole period of ownership basis to be applied.



Test your understanding 13

Erin

Taxable gain – 2024/25

	£
Sale proceeds	600,000
Less: Cost	(450,000)
	<hr/>
Capital gain before reliefs	150,000
Less: PRR (W1)	(45,000)
	<hr/>
	105,000
Less: Letting relief (W2)	(0)
	<hr/>
Chargeable gain	105,000
Less: AEA	(6,000)
	<hr/>
Taxable gain	99,000
	<hr/>

Workings

(W1) PRR

From 30 September 2017 until 5 April 2019 Erin was UK resident and occupied the property, so PRR can be claimed for these 18 months.

Erin did not spend 90 nights in the UK property for any of the tax years 2019/20 to 2024/25 and therefore they are treated as years of non-occupation for PRR purposes.

However, PRR is available for the last nine months unconditionally as the property has at some time been Erin's private residence.

Total occupation = $(18 + 9) = 27$ months

Period of ownership = 90 months

PRR = $£150,000 \times (27/90) = £45,000$

(W2) Letting relief

Letting relief is not available where the property has been rented without shared occupancy of the owner.

New and ongoing unincorporated businesses

Chapter learning objectives

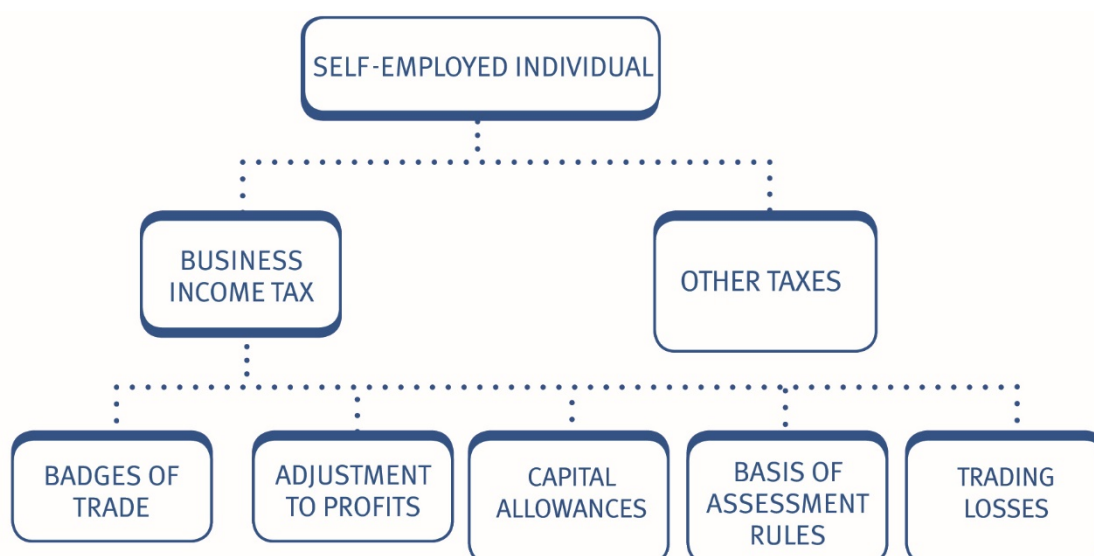
Upon completion of this chapter you will be able to:

- describe and apply the badges of trade
- prepare the tax adjusted trading profit/loss and capital allowances given a variety of situations
- advise on the allocation of the annual investment allowance between related businesses
- identify and advise on the taxes applicable to a given course of action and their impact
- identify and understand that the alternative ways of achieving personal or business outcomes may lead to different tax consequences
- assess the tax advantages and disadvantages of alternative courses of action
- understand the statutory obligations imposed in a given situation, including any time limits for action and advising on the implications of non-compliance
- identify and advise on the types of investment and other expenditure that will result in a reduction in tax liabilities for an individual and/or a business
- advise on legitimate tax planning measures, by which the tax liabilities arising from a particular situation or course of action can be mitigated

- advise on the appropriateness of such investment, expenditure or measures given a particular taxpayer's circumstances or stated objectives
- advise on the mitigation of tax in the manner recommended by reference to numerical analysis and/or reasoned argument.
- state which businesses can use the cash basis and flat rate expenses and explain how tax adjusted trading profits are calculated using this method
- explain the NIC position and calculate the NIC liability for a self-employed individual
- calculate the receipts from a transaction, net of tax and compare the results of alternative scenarios and advise on the most tax efficient course of action.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another performance objective (PO17) is to advise on mitigating and deferring tax liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate these objectives.



Introduction

This and the following two chapters deal with the way in which a self-employed individual is taxed on income derived from an unincorporated business (i.e. a sole trader or partnership).



There is little new knowledge at ATX compared with TX, therefore much of this chapter is a revision of business tax rules. However, examination questions will bring many of the business tax topics together in a scenario and will test an in-depth understanding of the different taxes that apply.

Common scenarios are the opening years of a business, ongoing years where there is a change in the operations or closing years.

After studying this chapter you should be able to tackle examination questions involving all tax aspects of a new or ongoing business.

The key considerations are as follows:

- Badges of trade – is a trade being carried on?
- Income tax issues for new and ongoing businesses
- Loss reliefs
- NICs
- Expansion: taking on an employee or partner
- VAT
- Self-assessment.

The new material is in respect of the emphasis placed on tax planning issues arising from the basic rules.

1 A revision of basic income tax

The badges of trade

Income arising from a trade, profession or vocation is taxed as trading income in an individual's income tax computation.

In entering into a transaction, or series of transactions, it is not always clear whether an individual is:

- carrying on a trade, and therefore subject to income tax and NICs, or
- making a capital disposal, which may be chargeable to capital gains tax (CGT) or is exempt from tax.



Illustration 1 – Trading income vs. gain

On 1 May 2023 Chow bought a derelict property at an auction for £132,000. She paid cash of £42,000, and borrowed the remaining £90,000 from her bank at an interest rate of 8% pa.

On 15 July 2023 Chow obtained planning permission to convert the property into six holiday apartments, and entered into a contract with a builder to carry out the conversion. The work was completed on 30 September 2023 at a cost of £63,000, and Chow immediately put the six holiday apartments up for sale.

Five of the holiday apartments were sold during November 2023 for £85,000 each. On 30 November 2023 Chow paid her builder and repaid the bank loan. She decided to keep the remaining holiday apartment, valued at £85,000, for her own use. Legal fees of £750 were paid in respect of each of the five holiday apartments sold, and advertising costs amounted to £1,200.

Since the sale of the holiday apartments is an isolated transaction Chow believes that it should be treated as a capital gain rather than as a trade.

Chow has not disposed of any other assets during the tax year 2023/24. She has other taxable income of £155,000 for the tax year 2023/24.

Calculate Chow's net cash position arising from her property activities during the tax year 2023/24 if this is treated as:

- (1) **trading income, and**
- (2) **a capital transaction.**

You should ignore the implications of NIC and VAT.

Solution**Chow's net tax position treated as if trading income**

If Chow is treated as trading she will be liable to income tax on the trading profit, including the holiday apartment retained by her which is treated as a disposal to her at its market value of £85,000.

Chow's income tax liability will be:

	Income tax	Net cash
	£	£
Sale proceeds (5 × £85,000)	425,000	425,000
Market value of property retained (Note 1)	85,000	–
Less: Cost of property	(132,000)	(132,000)
Less: Cost of conversion	(63,000)	(63,000)
Less: Loan interest (£90,000 × 8% × 7/12)	(4,200)	(4,200)
Less: Legal fees (5 × £750)	(3,750)	(3,750)
Less: Advertising	(1,200)	(1,200)
	<hr/>	
Taxable profit	305,850	
	<hr/>	
Income tax (45% × £305,850) (Note 2)	137,632	(137,633)
	<hr/>	
Net cash after tax		<hr/> 83,217 <hr/>

Note 1: The property retained must be taken into account for tax purposes, but is not real cash income.

Note 2: Income tax is at the additional rate of 45% as Chow's other taxable income is above £125,140.

Chow's net tax position if treated as capital

If Chow is treated as not trading, she will be subject to capital gains tax. The holiday apartment retained by her will not be charged to tax.

The disposal will be a part disposal, so the cost will be apportioned based on the formula:

$$\text{Cost} \times (A/A + B)$$

where A is the value of the flats sold and B is the value of the remainder. As all of the six flats are valued at £85,000 in this case, the cost of the five flats sold can be simplified to (cost × 5/6).

Chow's CGT liability will be:

	CGT £	Net cash £
Sale proceeds ($5 \times £85,000$)	425,000	425,000
Less: Incidental costs of disposal (£3,750 + £1,200)	(4,950)	(4,950)
Net sale proceeds	420,050	
Less: Cost of property ($£132,000 \times 5/6$)	(110,000)	(132,000)
Less: Cost of conversion ($£63,000 \times 5/6$)	(52,500)	(63,000)
Chargeable gain	257,550	
Less: AEA	(6,000)	
Taxable gain	251,550	
CGT ($28\% \times £251,550$) (Note 3)	70,434	(70,434)
Less: Loan interest (£90,000 \times 8% \times 7/12) (Note 4)		(4,200)
Net cash after tax		150,416

Note 3: Business asset disposal relief is not available on the capital disposal as the business it is not a trading business and Chow owned the property for less than two years. CGT is charged at 28% as the gain relates to residential property and Chow has none of her basic rate band remaining.

Note 4: Interest is not an allowable deduction for CGT purposes, however must be paid out of 'after tax proceeds' to calculate the net cash after tax position.

Future position

Note that if treated as trading, Chow is deemed to have acquired the 6th apartment for £85,000 on the date it is appropriated from inventory.

If treated as capital, Chow is also deemed to have acquired the 6th apartment worth £85,000 on 1 May 2023 for a CGT cost of £32,500 ($(£132,000 \times 1/6) + (£63,000 \times 1/6)$). This treatment will therefore give rise to a bigger gain in the future.

What constitutes a trade is therefore very important in deciding how profits should be taxed.

The badges of trade produced by the Royal Commission are criteria used to determine whether or not the purchase and resale of property is to be treated as a trading transaction.

The key badges of trade are as follows:

- the subject matter of the transaction (S)
- the length of the period of ownership (O)
- the frequency or number of similar transactions by the same person (F)
- supplementary work, improvements and marketing (I)
- the circumstances responsible for the realisation (R)
- the motive (M).

The following additional badges should also be considered:

- Finance (F)
- Method of acquisition (A)
- Existence of similar trading transactions (ST).



The badges of trade – detail

It may be helpful to remember the badges of trade by the mnemonics: SOFIRM and FAST as denoted by the letters in the brackets in the main text above.

However, it is vital to appreciate that:

- no single badge of trade will be decisive
- it is necessary to consider all of the facts surrounding the transaction
- in any set of circumstances some badges may indicate trading whilst others may not
- it is the overall impression, taking into account all relevant factors, that is important.

The principles behind each badge of trade and some background information relating to decided cases are given below.

The subject matter of the transaction (S)

Property which does not yield an income nor gives personal enjoyment to its owner is likely to form the subject matter of a trading transaction.

Other property such as land, works of art and investments are more likely to be acquired for the income and/or personal enjoyment that they provide. The disposal of such items will more often give rise to a gain or loss of a capital nature, rather than a trading profit.

In a decided case, the taxpayer purchased one million rolls of toilet paper which were resold at a profit. This was held to be an adventure in the nature of a trade, since it was inconceivable that the rolls of toilet paper were acquired for any purpose other than realising a profit.

The length of ownership (O)

The sale of property within a short time of its acquisition is an indication of trading.

By itself, however, this is not a strong badge as, for example, stocks and shares will often be bought and sold on an active basis without giving rise to an adventure in the nature of a trade.

Frequency of similar transactions (F)

Repeated transactions in the same subject matter will be an indication of trading. This badge is of particular importance when an isolated transaction would not otherwise be treated as an adventure in the nature of a trade.

In a decided case, it was held that although the single purchase and resale of a cotton mill was capital in nature, a series of four such transactions amounted to trading.

Hence, subsequent transactions may trigger a trading profits liability in respect of earlier transactions.

Improvements to the property (I)

Carrying out work to the property in order to make it more marketable, or taking steps to find purchasers, will indicate a trading motive.

In a decided case, a syndicate was held to be trading when it purchased a quantity of brandy which was then blended, re-casked and sold in lots over an 18-month period.

However, a taxpayer is entitled to make an asset more attractive to potential purchasers, without this being an indication of trading.

Reason responsible for the realisation (R)

A forced sale to raise cash for an emergency will by presumption indicate that the transaction is not an adventure in the nature of a trade.

Motive (M)

If a transaction is undertaken with the motive of realising a profit, this will be a strong indication of trading. However, the absence of a profit motive does not prevent a person from being treated as trading.

In a decided case, the taxpayer was held to be trading when he bought some silver as a hedge against devaluation and later resold it at a profit.

Finance (F)

If the taxpayer takes out a loan to buy an asset and expects to repay the loan from the proceeds of sale, this is an indication of trading.

Method of acquisition (A)

If the taxpayer acquired the asset by way of purchase rather than receiving it as a gift or by inheritance, this suggests the transaction is more likely to be an adventure in the nature of a trade than not.

Existence of similar trading transactions (ST)

If the transactions are similar to those of an existing trade carried on by the taxpayer, this is also an indication of trading.

An overview of the trading income assessment for an individual

To calculate the trading income to include in a self-employed individual's income tax computation, the following procedure should be used:

- (1) Calculate the tax adjusted trading profits.
- (2) Calculate the capital allowances available. Deduct capital allowances from the tax adjusted trading profits.
- (3) Apply the basis of assessment rules to the tax adjusted trading profit figure after capital allowances have been deducted.

Pro forma tax adjusted trading profits computation

There are four key types of adjustment to be made to the accounting profit to calculate the tax adjusted trading profit as follows:

	£
Net profit per accounts	X
Add back: Non-trading expenses (disallowable expenditure)	X
Trading income not credited in the accounts	X
Deduct: Non-trading income	(X)
Trading expenses not charged in the accounts	(X)
	<hr/>
Tax adjusted trading profits before capital allowances	X
Less: Capital allowances:	
Plant and machinery	(X)
Structures and buildings allowance (Chapter 2)	(X)
	<hr/>
Tax adjusted trading profits after capital allowances	X
	<hr/>

Tax adjusted trading profits are dealt with on an accruals basis unless the examination question states otherwise.



Note that the detailed rules for adjusting the accounting profits were covered in TX. These are still examinable at ATX. However, at ATX it is likely that only a few selected adjustments will be required, not a large adjustment to profits computation or a large capital allowances computation.

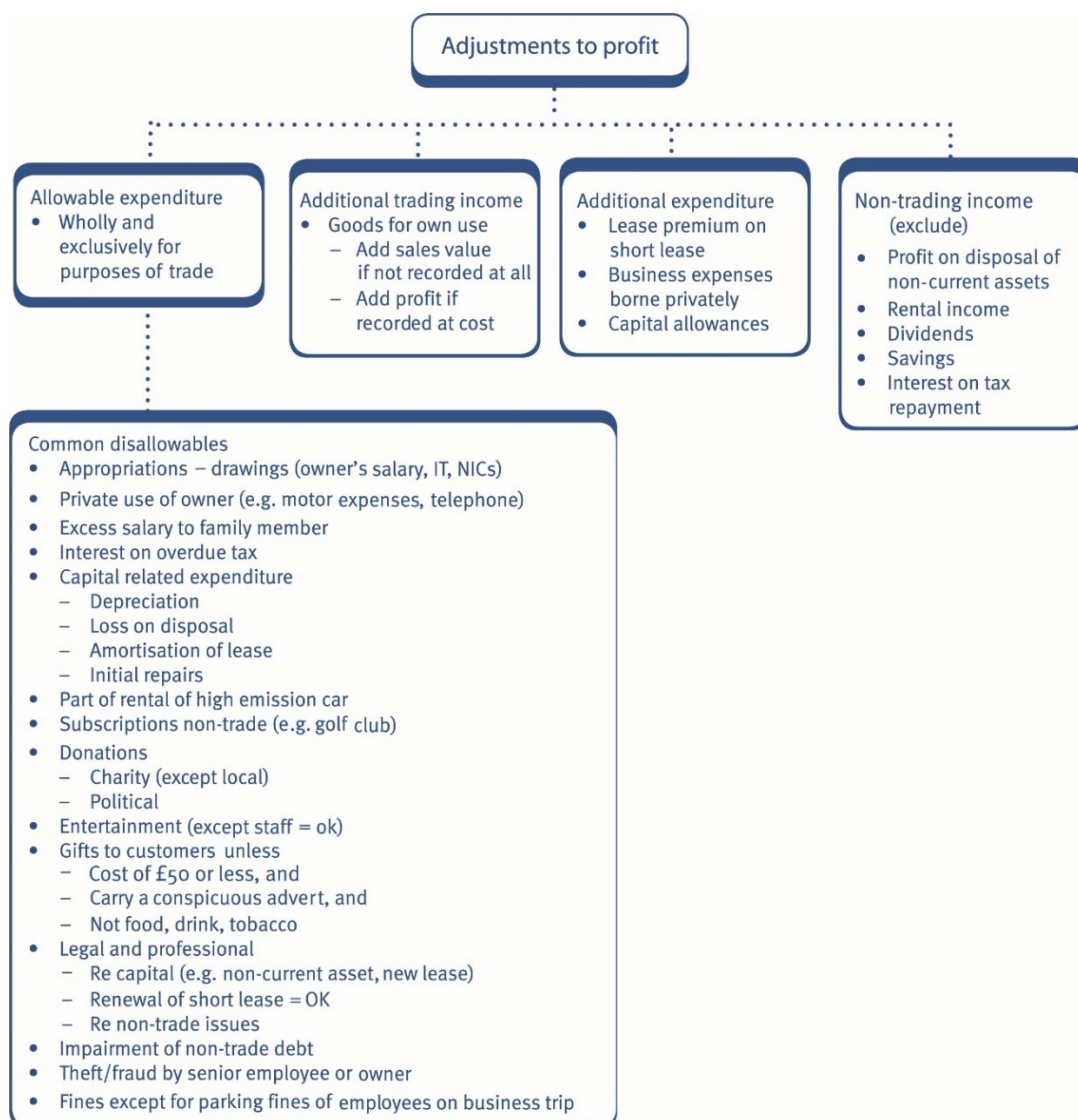
Basis of assessment rules

The basis of assessment rules determine in which tax year the adjusted trading profits will be taxed.

In the past, the normal basis of assessment was to tax the twelve-month accounting period ending in the current tax year, known as the 'current year basis' (CYB) of assessment.

However, from the tax year 2024/25 onwards this will be replaced by a tax year basis (see section 4).

2 The tax adjusted trading profits computation



Hiring and leasing a car

There is no adjustment where the CO₂ emissions of a leased car do not exceed 50g/km.

Where CO₂ emissions are more than 50g/km then 15% of the leasing costs are disallowed in calculating taxable profits.

The car is the most common asset with private use by the owner. In this case, a further adjustment is required to reflect the private use.



Allowable element of short lease premiums

The adjustments required for a short lease are:

Add:	the amortisation charged in the accounts (capital)
Deduct:	(the property income taxed on the landlord ÷ period of the lease)



Pre-trading expenditure

Any **revenue** expenditure incurred in the **seven years before a business starts trading** (which is of the type that would normally be allowed if incurred whilst trading) is treated as an allowable deduction against trading profit on the **first day of trading**.

Capital expenditure incurred within **seven years** of the start of the trade:

- is treated as incurred on the **first day of trading** and may be eligible for capital allowances
- however, the actual date of acquisition determines the rate of FYAs and AIA available (if any).

Comprehensive example

The following example revises the key adjustments to profit covered at TX.



Test your understanding 1

Oti is self-employed running a health food shop. Her statement of profit and loss for the year ended 31 March 2024 is as follows:

	£	£
Gross profit		124,200
Expenses		
Depreciation	2,350	
Light and heat (note 1)	1,980	
Motor expenses (note 2)	4,700	
Rent and rates (note 1)	5,920	
Sundry expenses (note 3)	2,230	
Wages and salaries (note 4)	78,520	
		(95,700)
Net profit		28,500

Note 1 – Private accommodation

Oti lives in a flat that is situated above the health food shop. 30% of the expenditure included in the accounts for light, heat, rent and rates relates to the flat.

Note 2 – Motor expenses

During the year ended 31 March 2024 Oti drove a total of 20,000 miles, of which 8,000 were for business purposes.

Note 3 – Sundry expenses

The figure of £2,230 for sundry expenses includes £220 for a fine in respect of health and safety regulations, £180 for the theft of cash by an employee, £100 for a donation to a political party, and £140 for a trade subscription to the Health and Organic Association.

Note 4 – Wages and salaries

The figure of £78,520 for wages and salaries includes an annual salary of £14,000 paid to Oti's daughter. She works in the health food shop as a sales assistant. The other sales assistants doing the same job are paid an annual salary of £10,500.

Note 5 – Goods for own use

Each week Oti takes health food from the shop for her personal use without paying for it. The weekly cost of this food is £30, and it has a selling price of £45. No entry has been made in the accounts for these drawings.

Note 6 – Plant and machinery

The only item of plant and machinery is Oti's car, which has CO₂ emissions of 48g/km. The tax written down value of this vehicle at 1 April 2023 was £16,667.

Note 7 – Copyright royalties

Oti pays a copyright royalty of £150 (gross) every quarter for the use of equipment that allows her to make her own organic breakfast cereal for sale in the shop. This has not been accounted for in arriving at the net profit of £28,500.

Other income

- (1) Oti has a part-time employment for which she was paid a salary of £10,000 during the tax year 2023/24. Income tax of £2,000 has been deducted from this figure under PAYE.
- (2) During the tax year 2023/24 Oti received building society interest of £5,800 and dividends of £800.
- (3) On 31 January 2024 Oti sold some shares from a 1% shareholding, and this resulted in a chargeable gain of £6,900.

Other information

- (1) During the tax year 2023/24 Oti paid interest of £220 (gross) on a loan taken out on 1 January 2021 to purchase equipment for use in her part-time employment.
 - (2) Oti contributed £5,000 (gross) into a personal pension scheme during the tax year 2023/24.
 - (3) Oti's payments on account of income tax in respect of the tax year 2023/24 totalled £4,559.
- (a) **Calculate Oti's tax adjusted trading profit for the year ended 31 March 2024.**
 - (b) **Calculate:**
 - (i) **the income tax and capital gains tax payable by Oti for the tax year 2023/24**
 - (ii) **Oti's balancing payment for the tax year 2023/24 and her payments on account for the tax year 2024/25, stating the relevant due dates.**
Ignore national insurance contributions.
 - (c) **Advise Oti of the consequences of not making the balancing payment for the tax year 2023/24 until 30 April 2025.**

3 Capital allowances



The detailed rules for calculating capital allowances were covered in TX.

There is little new technical knowledge on capital allowances at ATX compared with TX. The only new areas introduced at ATX are tax planning, and the awareness that the AIA is split between related businesses.

Most capital allowances are available on plant and machinery. In certain circumstances structures and buildings allowance (SBA) is available on non-residential buildings (see Chapter 2) at 3%.

Examination questions

Note that at ATX:

- large capital allowance computations with many additions and disposals as seen at TX are unlikely, less complicated computations will probably be required
- all of the knowledge in this chapter needs to be retained, however the computations are likely to focus on only a few aspects
- in some questions, it may be quicker and advisable to calculate allowances in single computations/workings rather than constructing a full pro forma

Basis of the calculation

Capital allowances are calculated on an accounting period basis.

If the accounting period is not 12 months long, the AIA and WDA must be time apportioned. Note that FYAs are never time apportioned.

Pro forma capital allowances computation

The following pro forma computation should be used for unincorporated businesses:

Pro forma capital allowances computation – unincorporated businesses

	Notes	Main pool	Special rate pool	Short life asset	Private use asset (Note 2)	Allowances
TWDV b/f		£	£	£	£	£
Additions:		X	X	X		
Not qualifying for AIA or FYA:	(1)					
Second-hand cars (0g/km)		X				
Cars (1 – 50g/km)		X				
Cars (over 50g/km)			X			
Car with private use					X	
Qualifying for AIA:						
Special rate pool expenditure		X				
AIA (Max £1,000,000 in total)	(3)	(X)				X
Transfer balance to special rate pool			X			
Plant and machinery		X				
AIA (Max £1,000,000 in total)		(X)				X
Transfer balance to main pool	(4)	X				
Disposals (lower of original cost or sale proceeds)		(X)		(X)		
BA / (BC)		X	X	X	X	X / (X)
Small pools WDA	(5)					
WDA @ 18%		(X)				X
WDA @ 6%			(X)			X
WDA @ 6%/18% (depending on emissions)					(X) × BU%	X
Additions qualifying for FYAs – New cars (0g/km)		X				
FYA @ 100%		(X)				
TWDV c/f		Nil				
Total allowances		X	X	X	X	X

Notes to the pro forma capital allowances computation

- (1) Cars are pooled according to their CO₂ emissions into either the main pool (sometimes referred to as the general pool) or special rate pool (SRP).
New electric-powered cars with zero emissions receive 100% FYA.
Second-hand zero emission cars should be added to the main pool and receive a WDA of 18%.
- (2) Cars with private use are depooled regardless of their CO₂ emissions, and only the business proportion of allowances can be claimed. However, the CO₂ emissions are important in determining the rate of WDA available.
- (3) Allocate the AIA to the SRP expenditure in priority to main pool plant and machinery assets as a WDA of only 6% is available on the SRP pool as opposed to 18% available on main pool items.
- (4) Expenditure qualifying for AIA in the main pool but exceeding the level of AIA available is eligible for a WDA of 18%.
- (5) Small pools WDA: where the balance on the main pool and/or SRP before calculation of the WDA is \leq £1,000, all of the balance can be claimed as a WDA.
- (6) The taxpayer does not have to claim all or any of the AIA or WDA.



The procedure for calculating capital allowances

For plant and machinery capital allowances, adopt the following step-by-step approach if a full computation is required:

- (1) Read the information in the question and decide how many columns/pools you will require.
- (2) Draft the layout and insert the TWDV b/f (does not apply in a new trade).
- (3) Insert additions not eligible for the AIA or FYAs into the appropriate column taking particular care to allocate cars into the correct column according to CO₂ emissions as relevant.
- (4) Insert additions eligible for the AIA in the first column, then allocate the AIA to the additions.

Remember to time apportion if the period of account is not 12 months.

Allocate the AIA to SRP additions in priority to additions of plant and machinery in the main or other individual asset pools.

- (5) Any SRP additions in excess of the AIA must be added to the SRP column to increase the balance available for 6% WDA.

Any main pool expenditure, in excess of the AIA, should be added to the main pool to increase the balance qualifying for 18% WDA.

- (6) Deal with any disposal by deducting the lower of cost or sale proceeds.
- (7) Work out any balancing charge/balancing allowance for assets in individual pools. Remember to adjust for any private use.
- (8) Consider if the small pools WDA applies to the main pool and/or the SRP.
- (9) Calculate the WDA on each of the pools at the appropriate rate (18% or 6%). Remember to:
 - time apportion if the period of account is not 12 months
 - adjust for any private use if an unincorporated business (not relevant for companies).
- (10) Insert additions eligible for FYAs (i.e. any new electric-powered cars with zero emissions)
Remember the FYA is never time apportioned.
- (11) Calculate the TWDV to carry forward to the next accounting period and add the allowances column.
- (12) Deduct the total allowances from the adjusted profits.



The Annual Investment Allowance (AIA)

The Annual Investment Allowance (AIA) is a 100% allowance for the first £1,000,000 of expenditure incurred by a business on plant and machinery.

The key rules for the allowance are as follows:

- available to **all** businesses regardless of size
- available on acquisitions of plant and machinery in the main pool and acquisitions of SRP items (see later)
- **not** available on cars
- **not** available on additions qualifying for SBA (see Chapter 2)
- limited to a maximum of £1,000,000 expenditure incurred in each accounting period of 12 months in length
- for long and short accounting periods the allowance is increased/reduced to reflect the length of the accounting period
- not available in the accounting period in which trade ceases.

Where a business spends more than £1,000,000 in a 12-month accounting period on assets qualifying for the AIA:

- the expenditure above the £1,000,000 limit will qualify for writing down allowances (WDA) (see below).

Note also that:

- the taxpayer can choose not to claim all/any of the AIA
- any unused AIA cannot be carried forward or carried back, the benefit of the allowance is just lost.

Expenditure on plant and machinery in the main pool/SRP not qualifying for AIA will qualify for WDAs.



The AIA amount of £1,000,000 is included in the tax rates and allowances provided to you in the examination.



AIA for related business

- The AIA must be split between related businesses.
Businesses owned by the same individual are regarded as related where they:
 - engage in the same activities, or
 - share the same premises.In such circumstances the owner of the businesses can choose how to allocate a single AIA between them.
- Unrelated businesses owned by the same individual will each be entitled to the full AIA.

Other points to note

- If VAT registered, include:
 - all additions of plant and machinery at the VAT-exclusive price
 - except cars with private use which are included at the VAT-inclusive price.
- If not VAT registered, include all additions at the VAT-inclusive amounts.
- If an asset is given in part-exchange for a new asset, then the part-exchange allowance will be treated as proceeds for the disposal of the old asset and part of the cost of the new asset.
- Pre-trading capital purchases:
 - include if incurred in the seven years before trade started
 - treated as acquired on the first day of trade at its market value on that day.

Summary of the capital allowances available for cars

The following table sets out the treatment of cars.

<ul style="list-style-type: none"> • Zero emission electric-powered <ul style="list-style-type: none"> – if new = FYA 100% – if second-hand = as for standard emission.
<ul style="list-style-type: none"> • Standard emission <ul style="list-style-type: none"> – emissions 1 – 50g/km – put in main pool – WDA 18% for 12-month period.
<ul style="list-style-type: none"> • High emission <ul style="list-style-type: none"> – emissions > 50g/km – put in special rate pool – WDA 6% for 12-month period.
<ul style="list-style-type: none"> • Private use cars <ul style="list-style-type: none"> – keep separate – WDA 18%/6% for 12-month period depending on emissions – Claim business use percentage of WDA – BA or BC will arise on disposal.

Note that:

- Cars are never eligible for AIAs
- Cars are not eligible for FYAs, unless a **new** electric-powered zero emission car.



Any exam questions involving the disposal of cars will make it clear to which pool the car was originally allocated on acquisition.



Special rate pool (SRP)

The SRP is a pool of qualifying expenditure that operates in the same way as the main pool except that:

- the WDA is 6% for a 12-month period (rather than 18%).

Note that:

- the AIA is available against this expenditure (except on high emission cars), and
- the business can choose the expenditure against which the AIA is allocated.

It will therefore be most beneficial for the AIA to be allocated against expenditure in the following order:

- (1) the SRP (as assets in the SRP are only eligible for 6% WDA, whereas general plant and machinery is eligible for 18% WDA).
- (2) the main pool
- (3) short life assets
- (4) private use assets.

Special rate pool – qualifying expenditure

The SRP groups together expenditure incurred on the following types of asset:

- long life assets
- integral features of a building or structure
- thermal insulation of a building
- high emission cars.

Qualifying expenditure includes

- initial cost, and
- replacement expenditure.



Qualifying replacement expenditure is expenditure which is more than 50% of the replacement cost of the integral feature at the time the expenditure is incurred.

It also includes situations where less than 50% is spent initially but further spending in the next 12 months takes the total over 50%.

This rule prevents businesses gradually replacing integral features and claiming the cost as a repair.



Long life assets

- Long life assets are defined as those with:
 - an expected working life of **25 years or more**
 - **total cost of £100,000** or more in a 12-month period of account (the limit is scaled down for periods of account of less than 12 months).
- If the definition is satisfied, the items must be treated as long life assets.
- Expected life:
 - from date first brought into use to the date it ceases to be capable of being used by anyone (i.e. not just the expected life in the hands of the current owner).

- Examples of long life assets:
 - aircraft, agricultural equipment, air conditioning units.
- Cars and plant and machinery situated in a building used as a retail shop, showroom, hotel or office can never be classified as a long-life asset.



Integral features of a building or structure and thermal insulation

Integral features of a building or structure include expenditure incurred on the following:

- electrical (including lighting) systems
- cold water systems
- space or water heating systems
- external solar shading
- powered systems of ventilation, air cooling or air purification
- lifts, escalators and moving walkways.

Thermal insulation in all business buildings (except residential buildings in a property business) is also included in the special rate pool.

Where a building is purchased and the exam question does not make it clear whether fixtures and fittings are included in the purchase price, there may be marks available for identifying that capital allowances could be claimed on any fixtures and fittings.



The small pool WDA

Where the balance immediately before the calculation of the WDA on the main and/or special rate pool is **≤ £1,000** the balance can be claimed as a WDA and written off in that year.

The £1,000 limit is for a 12-month period of account, it is therefore increased/reduced to reflect the length of the accounting period.

The claim is optional. However, the taxpayer will normally want to claim the maximum available and reduce the balance on the pool to £Nil.

Hire purchase assets

For **hire purchase** contracts:

- the individual is treated **as if** the asset was purchased outright
- when the contract was taken out (even though the individual does not legally own the asset until the final payment is made)
- the hire purchase interest is treated as an allowable trading expense of the period of account in which it accrues
- capital allowances are **based on the cash price** (excluding interest), regardless of the actual instalments paid in the period of account.

Comprehensive example



Illustration 2 – Capital allowances computation

Ashley runs a manufacturing business and prepares accounts to 31 December each year. During the year ending 31 December 2023 she incurred the following expenditure:

- | | |
|--------------|---|
| 1 June 2023 | Purchased new machinery for £40,000. |
| 3 June 2023 | Purchased a new car with CO ₂ emissions of 0g/km for £17,000. |
| 15 July 2023 | Purchased a new car with CO ₂ emissions of 53g/km for £18,000. |

In addition, on 1 July 2023 Ashley sold an old machine for £10,000 (original cost £15,000) and the short life asset for £7,000, which had originally cost £15,000.

As at 1 January 2023 the tax written down values were as follows:

Main pool	£64,000
Short life asset	£9,000

Calculate Ashley's capital allowances for the y/e 31 December 2023.

Solution**Capital allowances computation – y/e 31 December 2023**

		Main pool	Special rate pool	Short life asset	Allow- ances
	£	£	£	£	£
TWDV b/f		64,000	0	9,000	
Additions:					
Not qualifying for AIA or FYA:					
Car (CO ₂ emissions 53g/km)			18,000		
Qualifying for AIA:					
Plant and machinery	40,000				
AIA	(40,000)				40,000
		—			
Disposal (lower of cost and SP)		(10,000)		(7,000)	
		54,000	18,000	2,000	
Balancing allowance				(2,000)	2,000
WDA (18%)		(9,720)			9,720
WDA (6%)			(1,080)		1,080
Additions qualifying for FYA:					
Car (CO ₂ 0g/km)	17,000				
FYA (100%)	(17,000)				17,000
		0			
TWDV c/f		44,280	16,920	0	
Total allowances					69,800

Tax planning measures to reduce tax liabilities

An individual has scope within the capital allowance rules to ensure that:

- the amount of and use of allowances, reliefs and losses are maximised
- the tax liabilities of an individual are minimised.

Key opportunities which may arise:

- the ability to claim some, or none, of the capital allowances available, to enable more capital allowances to be claimed in future
- the ability to accelerate capital allowances with a short life asset election (for example, if the AIA limit has been exceeded).



Waiver of capital allowances

An individual does not have to claim the full entitlement to capital allowances if it would be advantageous not to do so.

A claim can be made in the self-assessment tax return for the whole or just part of the capital allowances available.

If a partial claim is made in one year:

- WDAs in subsequent years will be calculated on a higher TWDV figure than if the allowances had previously been claimed in full.
- Consequently, relief for the expenditure incurred will be delayed.
- However, note any unused AIA cannot be carried forward or carried back, the benefit of the AIA is lost.

It may be advantageous to waive the right to capital allowances:

- to make full use of the individual's personal allowance
- to reduce a trading loss and claim higher allowances in the future, rather than having to waste losses against income already covered by the personal allowance.



Illustration 3 – Waiver of capital allowances

Omar has been trading for many years. His taxable trading income for the year ended 31 March 2024 is £13,050 before taking account of any claim for capital allowances.

The TWDV of plant and machinery at 1 April 2023 is £12,000. He has made no additions or disposals in the year.

Omar is single and has no other income or outgoings.

Advise Omar on how much of his capital allowances he should claim for the year ended 31 March 2024.

Solution

Omar could claim a WDA of £2,160 ($£12,000 \times 18\%$), leaving a TWDV to carry forward of £9,840 ($£12,000 - £2,160$).

However, if he claimed the maximum allowance, his taxable income would be as follows:

	£
Trading income (£13,050 – £2,160)	10,890
Less: PA	(12,570)
	<hr/>
Taxable income	0
	<hr/>

He will have no taxable income, but will waste £1,680 (£12,570 – £10,890) of his PA. He should therefore restrict the claim for capital allowances to £480 to prevent the wastage of his PA.

His taxable income for the tax year 2023/24 will then be:

	£
Trading income (£13,050 – £480)	12,570
Less: PA	(12,570)
	<hr/>
Taxable income	0
	<hr/>

Although his taxable income is still £Nil, the TWDV carried forward is increased from £9,840 to £11,520 (£12,000 – £480), which will enable him to claim higher relief for capital allowances in subsequent periods.

The amount of capital allowances claimed is a particularly important tax planning tool in a trading loss situation. This is covered in more detail later in this chapter.



Accelerating capital allowances

The 'depooling' election to treat an asset as a short life asset enables a trader to accelerate capital allowances on certain types of short life plant or machinery, for example, computers.

However, if eligible for the AIA, there will be no expenditure left to 'depool' and the short life asset election will not be made. This means that there is no need to even consider the election unless the business has expenditure > £1,000,000 in a 12-month period.

Note that:

- If there is expenditure in excess of the maximum £1,000,000 on expenditure eligible for the AIA, it may be advantageous for the AIA to be allocated against the main pool expenditure rather than a short life asset and for the depooling election to be made.
- The depooling election is:
 - available on plant and machinery (except cars) where the intention is to sell or scrap the item **within eight years** of the end of the period of account in which the asset is acquired
 - beneficial if a BA arises on the disposal as it accelerates the capital allowances claim
 - not beneficial if it accelerates a balancing charge arising.

- The depooling election must be made within 12 months of 31 January following the end of the tax year in which the trading period of acquisition ends.
- If no disposal is made within eight years from the end of the accounting period in which the asset is acquired:
 - the balance on the separate short life asset column must be transferred back to the main pool
 - WDAs are claimed in the future in the normal way.

In order to determine whether making the election is beneficial, the trader must decide, within the time limit for the election, whether the asset is likely to be sold for more or less than its TWDV.

As the election is irrevocable and binding, if the individual finds that the disposal will crystallise a balancing charge, the disposal should be delayed until after eight years as it will then be included in the general pool and will not crystallise a charge.



Illustration 4 – Short life asset

Geeta has traded for many years preparing accounts to 31 March each year. The TWDV on the main pool was £15,000 on 1 April 2023.

In May 2023, she acquired a new machine costing £100,000. She anticipated that the machine would last two years and she eventually sold it on 30 June 2025, for £17,500.

In August 2023, she acquired general plant and machinery for £1,100,000.

Calculate the allowances available for each year, illustrating whether or not an election to treat the new machine as a short life asset would be beneficial.

Assume the rates for the tax year 2023/24 apply throughout.

Solution**Capital allowances computation
– without making a short life asset election**

		Main pool	Allowances
y/e 31 March 2024	£	£	£
TWDV b/f		15,000	
Additions qualifying for AIA:			
Plant and machinery (£1,100,000 + £100,000)	1,200,000		
AIA	(1,000,000)		1,000,000
		<u>200,000</u>	
		215,000	
WDA (18%)		<u>(38,700)</u>	38,700
TWDV c/f		176,300	
			<u>1,038,700</u>
Total allowances			
y/e 31 March 2025			
WDA (18%)		<u>(31,734)</u>	31,734
TWDV c/f		144,566	
			<u>31,734</u>
Total allowances			
y/e 31 March 2026			
Disposal (lower of cost and SP)		<u>(17,500)</u>	
		127,066	
WDA (18%)		<u>(22,872)</u>	22,872
TWDV c/f		104,194	
			<u>22,872</u>
Total allowances			

Capital allowances computation – with a short life asset election

	£	Main pool £	Short life asset £	Allowances £
y/e 31 March 2024				
TWDV b/f		15,000		
Additions qualifying for AIA:				
Plant and machinery	1,100,000		100,000	
AIA	(1,000,000)		(0)	1,000,000
		100,000		
		115,000	100,000	
WDA (18%)		(20,700)	(18,000)	38,700
		94,300	82,000	
TWDV c/f				
Total allowances				1,038,700
y/e 31 March 2025				
WDA (18%)		(16,974)	(14,760)	31,734
		77,326	67,240	
TWDV c/f				
Total allowances				31,734
y/e 31 March 2026				
Disposal (lower of cost and SP)			(17,500)	
		77,326	49,740	
Balancing allowance			(49,740)	49,740
		(13,919)		13,919
		63,407		
TWDV c/f				
Total allowances				63,659

The total allowances claimed without making the election are £1,093,306 (£1,038,700 + £31,734 + £22,872). In the event Geeta makes the election, the allowances available for the three years are £1,134,093 (£1,038,700 + £31,734 + £63,659).

Note that the election just accelerates the allowances available and only changes the timing of the allowances. The total allowances available will eventually be the same, however, without the election, it will take considerably longer to get the relief.

Therefore, if not covered by the AIA, it is recommended that the short life treatment is taken but only if it is expected that a balancing allowance can be accelerated. It is not advantageous to accelerate a balancing charge.



Test your understanding 2

On 1 January 2024, Gordon started self-employment running a music recording studio. He prepared his first set of accounts for the three months to 31 March 2024.

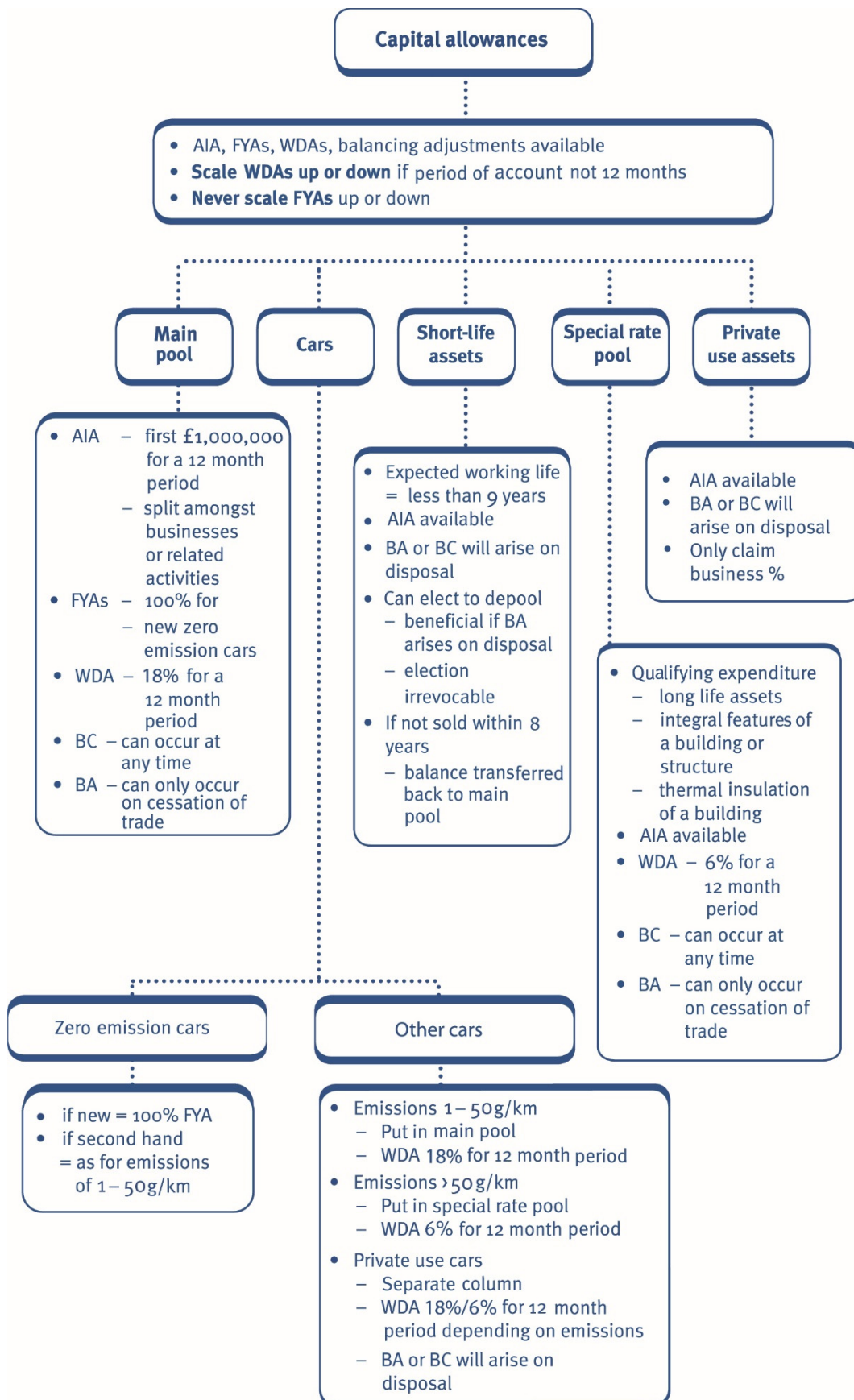
The following information relates to the three months to 31 March 2024:

- (1) The tax adjusted trading profit for the period is £349,340. This figure is before taking account of capital allowances.
- (2) Gordon purchased the following assets:

		£
1 January 2024	Recording equipment	300,000
15 January 2024	Car with CO ₂ emissions of 79g/km (used by Gordon – 60% business use)	15,800
20 February 2024	Car with CO ₂ emissions of 48g/km (used by employee – 20% private use)	10,400
4 March 2024	Recording equipment (expected to be scrapped in two years)	3,250

Calculate Gordon's taxable trading income for the period ended 31 March 2024.

Summary of capital allowances for plant and machinery



4 Basis of assessment rules

The basis of assessment rules determine in which tax year the adjusted trading profits will be taxed.

Basis period reform

In the past, the profits taxed were those of the 12-month accounting period ending in that tax year (current year basis (CYB)).

There were special opening year rules which led to the creation of overlap profits for any unincorporated business that did not have an accounting period ending on 5 April (or 31 March).

However, from the tax year 2024/25 onwards the current year basis of assessment will be replaced by a simpler tax year basis, whereby results will be time apportioned to tax the profits arising in the tax year.

The tax year 2023/24 will be a transitional year where special rules apply to any unincorporated business that does not have an accounting period ending on 5 April (or 31 March). For these businesses, any profits not yet taxed will be assessed along with the relevant number of months to take the assessment up to 5 April 2024.

All outstanding overlap relief will be given in the tax year 2023/24.

Where a business has profits which are higher in 2023/24 due to the change in basis, the additional transitional profits will automatically be spread over five years.

Examinability



The ATX examining team has confirmed the following for exams in the period 1 June 2024 to 31 March 2025:

- The calculation of transitional profits for the tax year 2023/24 will **not be examined**, although you should have an awareness that these profits will be taxed in the future.
- Unincorporated businesses will always have an accounting period ending on 5 April (or 31 March) in questions where you are required to calculate the assessable profits for a tax year.
- Some questions may involve an unincorporated business which does not have an accounting period ending on 5 April (or 31 March), but in this case the taxable trading profit for the relevant tax year(s) will be provided.
- The current year basis opening and closing year rules, together with overlap profits, will **not be tested**.
- If a question involves the commencement or cessation of an unincorporated business, the taxable trading profit for the relevant tax year(s) will be provided.

5 Trading losses for new and ongoing business



There is little new technical knowledge in respect of trading loss reliefs at ATX compared with TX.



The key difference at ATX is that exam questions at this level will usually involve giving tax advice and recommending a particular course of action to ensure the optimum use of trading losses in a particular scenario.

Such questions present opportunities for you to demonstrate your professional skills in the exam: in particular, your ability to analyse and evaluate information and to communicate advice clearly to your client.

Common scenarios are to look at losses in the opening years of business, the ongoing years, where there is a change in operations or the closing years (see Chapter 22).

It is necessary to have a firm grasp of the basic trading loss rules in order to:

- identify the suitable tax planning measures available
- be able to recognise the consequences, advantages and disadvantages of taking different courses of action.

The calculation of a trading loss

A trading loss occurs when the normal tax adjusted trading profit computation gives a negative result.

Where a trading loss occurs:

- the individual's trading income assessment will be £Nil
- a number of loss relief options are available to obtain relief for the loss.



Calculation of trading loss

	£	£
Tax adjusted trading profit/(loss) before capital allowances	X	(X)
Less: Capital allowances	(X)	(X)
	<hr/>	<hr/>
Trading loss	(X)	(X)
	<hr/>	<hr/>

Note that:

- capital allowances are taken into account in calculating the amount of the trading loss available for relief
- capital allowances:
 - can increase a tax adjusted trading loss, and
 - can turn a tax adjusted trading profit into a trading loss.

6 Loss relief options available

An individual trader has the following choice of options:

	Opening years	Ongoing years	Closing years
Relief against total income	✓	✓	✓
Relief against chargeable gains	✓	✓	✓
Carry forward of trading losses	✓	✓	x
Opening years loss relief	✓	x	x
Terminal loss relief	x	x	✓
Incorporation relief	x	x	✓

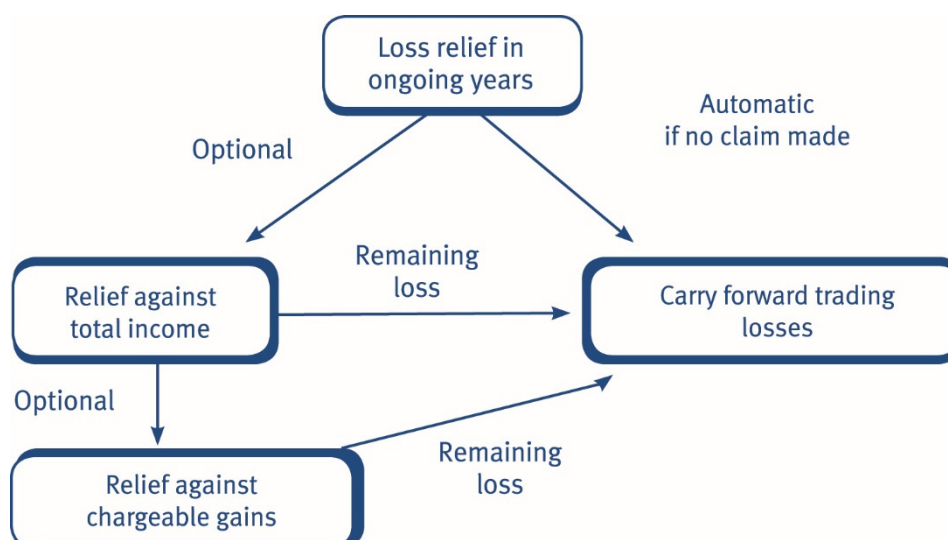
Loss relief options in ongoing years

If an individual makes a trading loss in the ongoing years, the individual will initially have to decide whether to claim relief against total income or carry forward all of the loss.

Where a claim against total income is made, any remaining loss is automatically carried forward unless the individual then makes a claim to set the loss against chargeable gains.

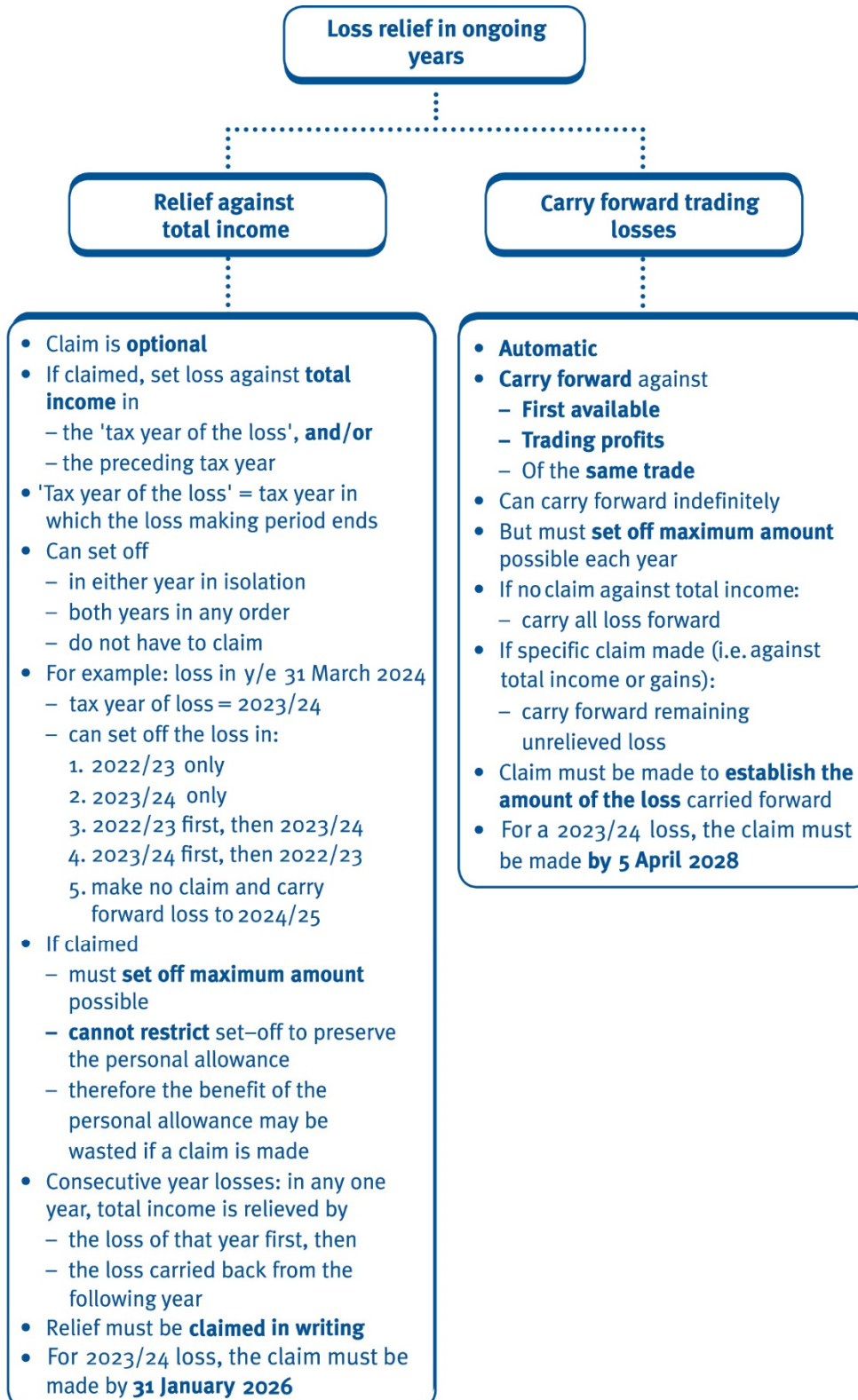
Note that a claim against gains can only be made after a claim against total income has been made. Any remaining loss is automatically carried forward.

The choices can be summarised as follows:



Relief against total income and carry forward

The key rules relating to the above reliefs are unchanged from TX and are summarised as follows:



A revision of the rules for relief against chargeable gains

The key rules relating to relief against chargeable gains are unchanged from TX and can be summarised as follows:

Relief against chargeable gains

- A claim against chargeable gains can **only be made if a claim against total income has been made** in that tax year first
- Claim is **optional**
 - if not claimed, the remaining loss is automatically carried forward.
- Amount of claim against chargeable gains = **lower of:**

	£
(i) Total gains in year	X
All capital losses in the year	(X)
All capital losses brought forward	(X)
	<u>X</u>
(ii) Remaining loss after claim against total income	<u>X</u>
- If claimed, treat the trading loss **as if** it is a **current year capital loss** in the capital gains tax computation
- **Claim** can be **made in the same tax years as a claim** against total income
- If claimed
 - must **set off maximum amount possible**
 - **cannot restrict set-off** to preserve the annual exempt amount
 - therefore the benefit of the annual exempt amount may be wasted if a claim is made
- Relief must be **claimed in writing**
- For 2023/24 loss, the claim must be made by **31 January 2026**

Note that utilising losses against gains will normally save tax at 10% or 20% (unless gain is in respect of residential property).



Illustration 5 – Relief against chargeable gains

Diana prepares her accounts to 31 March each year.

Her recent results have been as follows:

		£
y/e 31 March 2024	Tax adjusted trading profit	7,000
y/e 31 March 2025	Trading loss	(18,500)

Diana has received bank interest of £3,450 and dividends of £330 in the tax year 2023/24.

She realised the following chargeable gains in the tax year 2023/24:

	£
Asset 1	16,000
Asset 2	14,360

She has capital losses brought forward of £1,375.

Calculate Diana's taxable income and taxable gains for the tax year 2023/24, assuming that she decides to claim relief for her losses against her total income and against her gains in the tax year 2023/24 only.

Solution

- Diana's loss occurs in y/e 31 March 2025 = in 2024/25.
- She is entitled to claim relief against total income in 2024/25 and/or 2023/24.
- She has decided to claim relief in 2023/24 only.
- Therefore, only allowed to claim relief against gains in 2023/24.

Income tax computation – 2023/24

	£
Trading income	7,000
Bank interest	3,450
Dividends	330
	<hr/>
Total income	10,780
Less: Loss relief	(10,780)
	<hr/>
Net income	0
Less: PA	(Wasted)
	<hr/>
Taxable income	0
	<hr/>

Note that the PA, the savings and the dividend nil rate bands are wasted.

Claim against chargeable gains = lower of:

	£
(i) Total gains in year	30,360
All capital losses in the year	(0)
All capital losses brought forward	(1,375)
	<hr/>
	28,985
	<hr/>
(ii) Remaining loss after claim against total income (£18,500 – £10,780)	7,720
	<hr/>

Therefore, claim £7,720 relief and treat it as if it is a current year capital loss in the capital gains computation as follows:

Capital gains tax computation – 2023/24

	£
Asset 1	16,000
Asset 2	14,360
	<hr/>
Total chargeable gains	30,360
Less: Trading loss relief	(7,720)
Less: AEA	(6,000)
	<hr/>
Net chargeable gains	16,640
Less: Capital loss b/f	(1,375)
	<hr/>
Taxable gains	15,265
	<hr/>

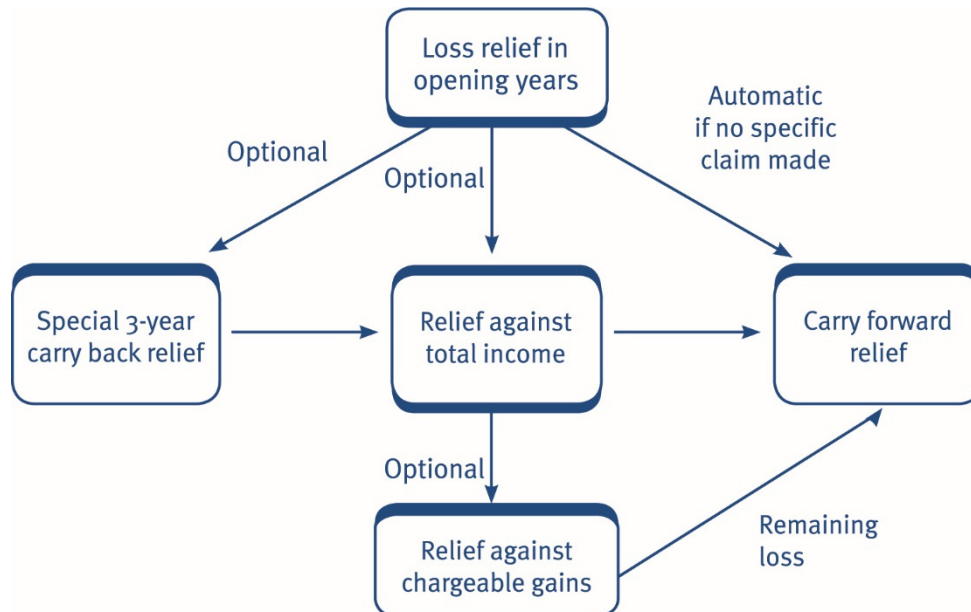
CGT saved will be £772 (£7,720 at 10%), as the gains offset against the losses would have fallen within the basic rate band.

Note: The trading loss is treated as a current year capital loss and therefore must be set off before capital losses brought forward.

Loss relief options in opening years

The options available in the opening years of trade are exactly the same as those available to an ongoing business, but with one extra option available: three year carry back against total income.

The choices can be summarised as follows:



However, before a particular loss relief can be claimed it is necessary to determine the loss arising in each tax year.

Calculation of loss in opening years



For exams in the period 1 June 2024 to 31 March 2025:

- The current year basis opening year rules will **not be tested**.
- If a question involves the commencement of an unincorporated business, the taxable trading profit or allowable loss for the relevant tax year(s) will be provided.



Choice of loss relief in opening years

If an individual makes a trading loss in the opening years, the individual will have to decide whether to claim normal relief against total income, special opening year loss relief or carry forward all of the loss.

Where a normal claim against total income is made, any remaining loss is automatically carried forward unless the individual decides to make a claim against chargeable gains or special opening year claim.

Note that an individual can claim both normal relief against total income and opening year relief if there are sufficient losses. However, the individual must utilise the maximum amount of loss under one claim first, and can only make the other claim with the remaining loss.

Where a special opening year claim is made, any remaining loss is automatically carried forward unless the individual decides to make a normal claim against total income (and a possible extension against gains can then be considered).

Note that a claim against chargeable gains can only be made after a normal claim against total income has been made.

Special opening year loss relief

Special opening year relief against total income

:

- Optional claim
- Applies to loss arising in any of **first 4 tax years** of trading
- If claimed, set loss against
 - **total income**
 - **in 3 tax years** before tax year of loss
 - on a FIFO basis (i.e. earliest year first)
- There is no need for the trade to have been carried on in the earlier years
- **One claim** covers all 3 years
- For example:

Loss in 2023/24 will be set off in:

 1. 2020/21
 2. 2021/22
 3. 2022/23
- If claimed
 - Must set off **maximum amount possible**
 - Cannot restrict set-off to preserve the personal allowance
 - Therefore, the benefit of the personal allowance may be wasted if a claim is made
- For 2023/24 loss, the claim must be made by 31 January 2026

The procedure for dealing with questions involving losses

The following procedure should be adopted when answering questions:

- (1) Determine the tax adjusted profits and losses after capital allowances for each accounting period.
- (2) Determine when losses arise and therefore when loss relief is available (i.e. in which tax years).
- (3) Set up a pro forma income tax computation for each tax year side by side and leave spaces for the loss set off to be inserted later.
- (4) Set up a loss memo working for each loss to show how it is utilised.
- (5) If more than one loss – consider in chronological order.
- (6) Consider each option – be prepared to explain the options, the consequences of making a claim, the advantages and disadvantages.
- (7) Set off losses according to the requirements of the question, or in the most beneficial way if it is a tax planning question.

Pro forma income tax losses computation

For a new business starting in the tax year 2023/24 where loss arising in 2023/24

	2020/21	2021/22	2022/23	2023/24	2024/25
	£	£	£	£	£
Trading income				0	X
Less: Loss relief b/f					(X)
				0	X
Employment income	X	X	X	0	
Other income	X	X	X	X	X
Total income	X	X	X	X	X
Standard loss relief			(X)	(X)	
Opening years relief	(X)	(X)	(X)		
Net income	X	X	X	X	X
Less: PA (if applicable)	(X)	(X)	(X)	(X)	(X)
Taxable income	X	X	X	X	X

	2023/24
Loss working	£
Trading loss	X
Utilisation of loss:	
Opening years relief against total income (strict FIFO order)	(X)
Standard relief against total income (any order)	(X)
	—
C/f against future trading profits	X
	—

Tax planning with trading losses

The primary aims of tax planning for trading losses

When planning relief for trading losses, careful consideration needs to be given to the personal circumstances of the individual.

Tax advice should aim to satisfy the following goals of a taxpayer:

- Obtain tax relief at the highest marginal rate of tax.
- Obtain relief as soon as possible.
- Ensure that the taxpayer's PAs, savings and dividend nil rate bands are not wasted, if possible.

It may not be possible to satisfy all of these aims, for example:

- in order to get a higher rate of relief, the taxpayer may have to waste the PA and/or nil rate bands
- carrying losses forward may give a higher rate of relief, but the cash flow implications of claiming relief now rather than waiting for relief may be more important to the taxpayer.

In examination questions you will be given a scenario and the tax advice must address the specific facts of the situation presented.

Factors to consider

In understanding the position of the taxpayer, it is important to understand the key features of the reliefs available.



Test your understanding 3

Jeremy started in business and had the following results for his first three tax years:

	£
2022/23: Trading loss	(30,000)
2023/24: Trading loss	(10,000)
2024/25: Trading profit	16,000

Prior to setting up in business he was employed and his employment income has been as follows:

	£
2019/20	23,000
2020/21	23,000
2021/22	24,000
2022/23	4,000

He had rental income of £1,000 for the tax years 2019/20 and 2023/24 only.

Show the loss claims if loss relief is claimed in the most beneficial way. You should briefly explain the relief available under each scenario.



Maximum deduction from total income

There is a limit on the amount of relief that can be deducted from total income in any tax year. The limit applies to trading losses and/or qualifying loan interest.

The **maximum deduction** from total income is the **greater of**:

- £50,000, or
- 25% of adjusted total income.

Adjusted total income (ATI) is calculated as follows:

	£
Total income	X
Add: Payroll deduction scheme contributions	X
	<hr/>
	X
Less: Gross personal pension contributions	(X)
	<hr/>
Adjusted total income	X
	<hr/>

However, the ATX examining team has confirmed that only the personal pension contribution deduction will be required at ATX.

Note that the restriction will be £50,000 unless the individual's ATI exceeds £200,000 (as $£200,000 \times 25\% = £50,000$).

The limit applies to trading losses set against:

- current year total income, and
- earlier years **if** set against income other than profits of the same trade.

It does not apply where the trading loss is set against profits from the same trade of an earlier year. Note that in this instance, trading losses are set against trading income from the same trade before income from other sources.

Any trade loss that cannot be set off against total income can be offset against chargeable gains of the same tax year in the usual way, or carried forward against future trade profits from the same trade.

However, note that the rules only restrict the loss that can be set off against total income, not chargeable gains.

As the reliefs against total income are 'all or nothing', it is possible that this restriction of the amount of the loss allowed to be deducted could be beneficial and prevent the wastage of personal allowances and nil rate bands.



Test your understanding 4

Luca is a sole trader and has adjusted trading results as follows:

Tax year 2022/23 £72,000

Tax year 2023/24 (£142,000)

He also has property income of £80,000 each year.

He does not make any charitable donations but contributes £5,000 cash to a personal pension scheme each year.

He wishes to offset his trading loss against his total income for the tax year 2023/24 and then 2022/23.

Calculate Luca's taxable income for the tax years 2022/23 and 2023/24.

Assume that the tax year 2023/24 rates and allowances apply throughout.

The above TYU considers the restriction of trading losses in the current and preceding year.

Note that the restriction is also relevant:

- when the special opening year loss relief rules are applied and the loss is carried back to earlier years, and
- where a claim is made to treat a capital loss on qualifying unquoted trading company shares as if it is a trading loss and is set against total income (Chapter 8).

Excess qualifying loan interest cannot be set off in any other year so if a taxpayer has both losses and qualifying loan interest the taxpayer can choose to deduct the loan interest first.

7 Simplification of accounting and taxation for unincorporated businesses

Cash basis option for small businesses

Unincorporated businesses (i.e. sole traders and partnerships):

- can choose to calculate profits/losses on:
 - a cash basis (i.e. on the basis of cash received and expenses paid in the **period of account**), rather than
 - the normal accruals basis
- provided they have turnover of £150,000 or less.

The rules are the same as seen in Chapter 18 for property income.

The cash basis option is not available to:

- companies, and
- limited liability partnerships (LLPs).

If an unincorporated business chooses the cash basis, it can continue to account on this basis until its annual turnover exceeds £300,000.



Note that the cash basis is optional and the detailed rules are complex, however, the ATX examining team has confirmed that:

- only the level of detail in this section is examinable, and
- it should be assumed in all questions involving sole traders and partnerships that the cash basis does not apply unless it is specifically referred to in the question.

Under the cash basis:

- the business accounts for cash receipts and payments in the period of account
- the business (like any other business) can prepare its accounts to any date in the year
- there is no distinction between capital and revenue expenditure in respect of plant, machinery and equipment for tax purposes, therefore:
 - purchases are allowable deductions when paid for, and
 - proceeds are treated as taxable cash receipts when an asset is sold
 - capital allowances remain available for expenditure on cars only; the capital cost is not an allowable deduction when paid
 - there is no relief for purchases of land and buildings
- in the ATX exam, the flat rate expense deduction for car expenses is claimed (see below) instead of capital allowances.

The key advantages of the cash basis are:

- simpler accounting requirements as there is no need to account for receivables, payables and inventory
- profit is not accounted for and taxed until it is realised and therefore cash is available to pay the associated tax liability.

However, the main disadvantage is that:

- losses can only be carried forward to set against future trading profits, whereas under the accruals basis many more options for loss relief are available.

Flat rate expense deduction option for any unincorporated business

Any unincorporated business (whether or not they are using the cash basis) can:

- opt to use flat rate expense adjustments
- to replace the calculation of actual costs incurred in respect of certain expenses.



However, note that the ATX examining team has confirmed that:

- if the cash basis applies, the use of flat rate expenses should be assumed to also apply.

The flat rate expense adjustments that are examinable are as follows:

Type of expense	Flat rate expense adjustment
Motoring expenses = capital costs and running costs (e.g. insurance repairs, servicing and fuel)	Allowable deduction = amount using the AMAP rates of 45p and 25p per mile (i.e. same allowance as for employed individuals use of own car and in a property business – Chapter 18)
Private use of part of a commercial building = private accommodation in a guest house or small hotel (e.g. a bed and breakfast)	Private use adjustment re household goods and services, food and utilities = fixed amount based on the number of occupants Note that the private element of other expenses (e.g. mortgage interest and rates) must be adjusted for as normal.

In the ATX exam, if the flat rate expense adjustment for private use of a commercial building is required, it will be provided within the question.



The AMAP rates are included in the tax rates and allowances provided to you in the examination.

Note: When you are asked to calculate taxable profit using the cash basis, you should begin your calculation with revenue received, and make any necessary deductions or additions to this figure. It is possible to calculate the correct answer by adjusting the net profit as you would under the accruals basis. However, this method is likely to be more time consuming and complicated.



Test your understanding 5

Rosemarie opened a bed and breakfast on 1 August 2023 and has prepared her first set of accounts to 5 April 2024.

Her accountant prepared her statement of profit or loss for the period ended 5 April 2024 as follows:

	Notes	£	£
Revenue	(1)		48,035
Less: Food, utilities and other household goods	(2)		(15,670)
			<hr/>
Gross profit			32,365
Depreciation	(3)	2,500	
Motor expenses	(4)	4,200	
Other expenses (all allowable)	(5)	14,500	
		<hr/>	(21,200)
			<hr/>
Net profit			11,165
			<hr/>

- (1) Revenue includes £6,575 which is still receivable at 5 April 2024.
- (2) Rosemarie paid for 80% of her purchases by 5 April 2024 and the remainder in June 2024. There is no closing inventory at 5 April 2024. Rosemarie lives with her husband at the bed and breakfast, and £4,900 of the costs relate to their personal use.
- (3) The depreciation charge relates to the fixtures, fittings and equipment bought in the period for £9,000 and a car purchased on 1 August 2023. Rosemarie purchased the car with CO₂ emissions of 48g/km for £9,600 and she uses the car 70% for business purposes.

- (4) The motor expenses of £4,200 relate to Rosemarie's car and in the period she drove 11,000 business miles.
- (5) The other expenses are all allowable for tax purposes, however Rosemarie paid for £460 of the expenses in June 2024.

The cash basis private use adjustment for two occupants in a business premises for eight months is £4,000.

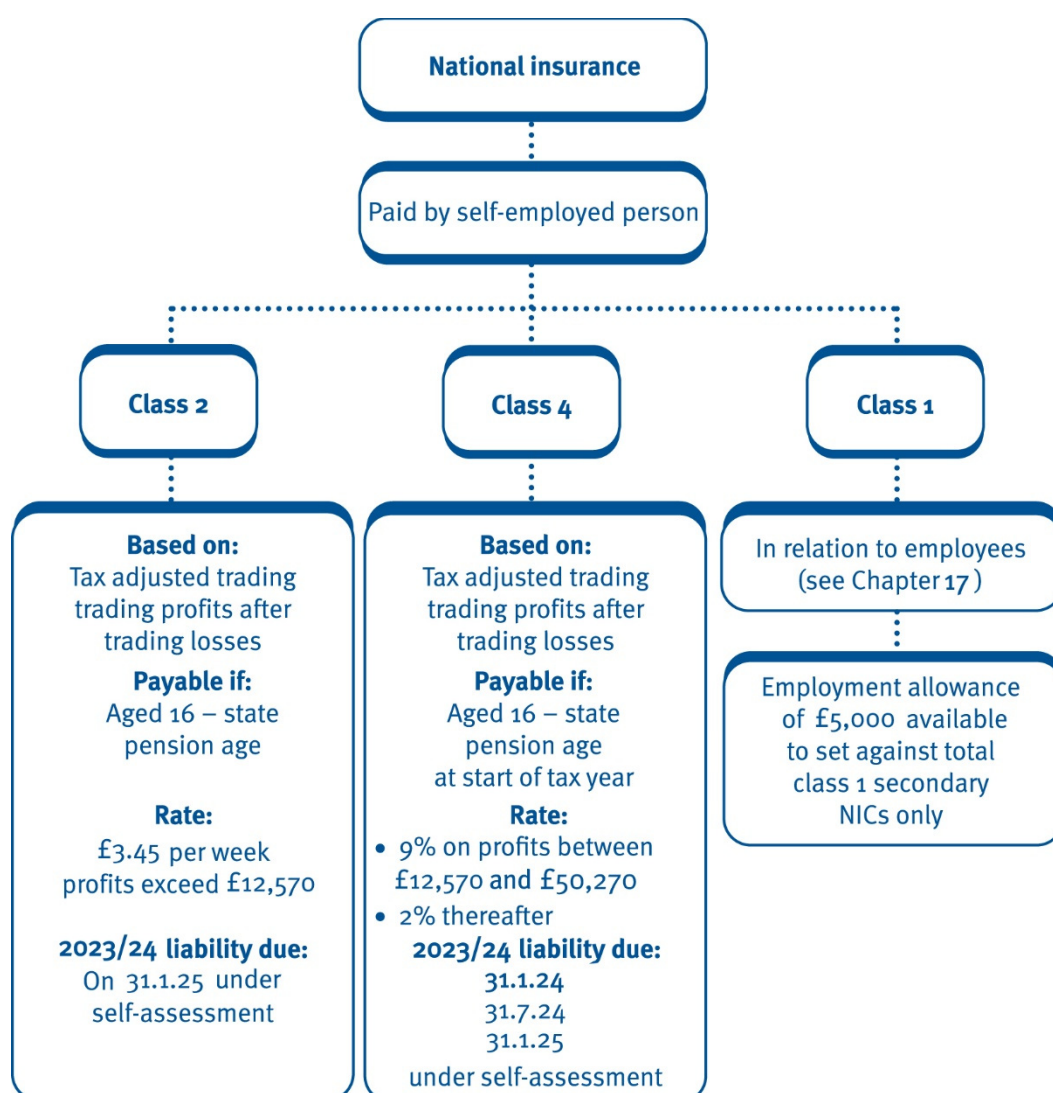
Calculate Rosemarie's tax adjusted trading profit for the year ended 5 April 2024 assuming:

- (a) She uses the normal accruals basis of accounting.
- (b) She uses the cash basis.

8 NICs payable in respect of self-employed individuals

A reminder of the rules for class 2 and class 4 contributions covered at TX is given in supplementary reading and are summarised in the diagram below.

Summary of total NICs payable





Class 2 contributions

Class 2 contributions are payable:

- where the individual is aged 16 or over
- until attaining state pension age
- if the tax adjusted trading profits of the business for the tax year exceed the lower profits limit of £12,570.

The key facts to remember about class 2 NICs are:

- Class 2 contributions are a flat rate payment of £3.45 per week.
- The maximum total class 2 NICs payable for the tax year 2023/24 is therefore £179 (£3.45 × 52 weeks).
- Class 2 contributions are
 - not an allowable deduction for the purposes of calculating the individual's income tax liability.
 - not a deductible expense when calculating the business' taxable trading profits.

Payment of class 2 contributions

Class 2 NICs are collected by HMRC through the self-assessment system.

Payment is due by 31 January following the end of the tax year, along with the balancing payment for income tax, class 4 NICs and capital gains tax.



State pension age

By 2018 the state pension age was 65 for both men and women, and this is gradually increasing.



Class 4 contributions

In addition to class 2 NICs, a self-employed individual may also be liable to class 4 NICs.

Class 4 contributions are payable by self-employed individuals who:

- **at the start of the tax year**, are aged 16 or over.

The individual continues to pay until:

- **the end of the tax year** in which the individual reaches state pension age.

The key facts to remember about class 4 NICs are:

- Class 4 NICs are a percentage-based contribution levied on the 'profits' of the individual in excess of £12,570 for the tax year 2023/24.
- Contributions payable are calculated as follows:
 - 9% on profits between £12,570 and £50,270 per annum
 - 2% on profits in excess of £50,270.
- Class 4 contributions are
 - not an allowable deduction for the purposes of calculating the individual's income tax liability
 - not a deductible expense when calculating the business' taxable trading profits.
- 'Profits' for the purposes of class 4 NICs consist of:
 - the taxable trading profits of the individual which are assessed to income tax
 - **after** deducting trading losses (if any).

Note that 'profits' for class 4 NICs are **before** deducting the individual's PA which is available for income tax purposes.

- If the individual has more than one business, the aggregate of all profits from all self-employed occupations are used to calculate the class 4 NIC liability.

Payment of class 4 contributions

Class 4 contributions are paid to HMRC at the same time as the individual's income tax payments.

Income tax and class 4 NICs due are paid under self-assessment, as follows:

Payment	Due date	Amount
Payments on account	<ul style="list-style-type: none"> • 31 January in the tax year (i.e. 31 January 2024 for 2023/24) • 31 July following the end of the tax year (i.e. 31 July 2024 for 2023/24) 	Two equal instalments of: <ul style="list-style-type: none"> • 50% of the amount paid by self-assessment in the preceding year
Balancing payment	<ul style="list-style-type: none"> • 31 January following the end of the tax year (i.e. 31 January 2025 for 2023/24) 	Under or overpayment for the year



Test your understanding 6

James has been trading as a self-employed painter and decorator since 2008. His taxable trading profits for the tax year 2023/24 are £62,000 and he has trading losses brought forward of £10,000.

His wife, Celine, is a part-time mobile hairdresser. Her taxable trading profits for the tax year 2023/24 are £15,000.

Calculate the class 2 and class 4 NICs payable by James and Celine for the tax year 2023/24.



NICs: Self-employed individuals

A self-employed individual pays both class 2 and class 4 NICs in respect of tax adjusted trading profit.

In addition, if the self-employed individual employs staff, the individual will be required to account for:

- Class 2 and class 4 NICs in respect of trading profits, and
- Class 1 employee, class 1 employer and class 1A NICs in respect of earnings and benefits provided to employees. £5,000 relief is available for businesses to set off against the total employer's class 1 NIC bill, with the exception of a business whose class 1 NIC bill was at least £100,000 in the previous tax year.

9 Employee versus partner

A popular scenario in the examination is the consideration of expanding the business and taking on an individual, often a spouse, as either an employee or a partner.

This section sets out a summary of the tax implications.

Employment of individuals in the business

- Employment costs (salaries, cost of providing benefits, employer's NICs) are tax deductible expenses for the employer.
- Employer's NICs can be avoided or reduced by taking on fewer full time staff and more part time staff because of the threshold at which NIC becomes payable.
- However, there is an increased administrative burden of employing staff.
- Alternatively, work could be subcontracted to self-employed individuals, avoiding the need to pay employer's NICs.

Employee

	Implications for sole trader	Implications for employee
Salary	<ul style="list-style-type: none"> • Allowable deduction from trading profits • Employer's class 1 NICs payable at 13.8% on earnings over £9,100 p.a. (allowable deduction from trading profits) £5,000 p.a. relief available • PAYE compliance burden 	<ul style="list-style-type: none"> • Taxed on employment income – receipts basis • Employee's class 1 NICs payable at 12% (£12,570 – £50,270 p.a.) and 2% thereafter – deducted under PAYE
Provision of car	<ul style="list-style-type: none"> • Capital allowances 100% FYA or WDA of 18% or 6% depending on CO₂ emissions. • Allowable deduction from trading profits • No private use restriction for employee usage • Running costs allowable in full as deduction from trading profits • Employers class 1A NICs at 13.8% of taxable benefits (allowable deduction from trading profits) 	<ul style="list-style-type: none"> • Benefit under employment income rules based on CO₂ emissions • Reduction in benefit for contribution toward private use

Setting up a partnership or taking on a partner

- Where two or more individuals are in partnership (rather than in the sole trader and employee relationship) then there is a NIC saving and a spreading of the tax burden.
- A partner
 - shares profit allocation
 - there is no employer's NIC to pay.

Each partner is subject to the trading profit basis period rules and is responsible for his, her or their own income tax, class 2 and class 4 NICs.

The detailed rules covering how partnerships are taxed are set out in Chapter 23.

Partner

	Implications for sole trader (existing partner)	Implication for new partner
Salary (profit share)	<ul style="list-style-type: none"> • Not allowable deduction from trading profits • Trading assessment on share of profits • No additional NICs 	<ul style="list-style-type: none"> • Trading assessment on share of profits • Class 2 NICs payable – £3.45 per week • Class 4 NICs payable – 9% on share of profits (£12,570 – £50,270) and 2% thereafter • Tax and class 4 NICs payable under self-assessment
Provision of car	<ul style="list-style-type: none"> • Capital allowances for partners' cars = 100% FYA or WDA of 18% or 6% depending on emissions, based on cost • Allowable deduction from trading profits of the partnership • Private use restriction for partners' usage – only claim business use proportion • Running costs allowable as deduction from trading profits – business use proportion only • No NICs on cars (as no employment) 	



Test your understanding 7

Henry has been in business as a sole trader for a number of years, and makes annual profits of £80,000. Henry currently has no other employees.

He wants to involve his wife Mary in the business, either as an employee or as a partner, and is considering the following options:

- (i) Employing Mary at a gross salary of £30,000 p.a.
- (ii) Running the business in equal partnership with Mary.

Both Henry and Mary had rental income each year of £12,570.

- (a) **Calculate the total annual tax payable by Henry as a sole trader.**
- (b) **Calculate the total annual tax saving for the couple under each of the suggested alternatives.**

10 VAT

The key issues that may be relevant to a new or ongoing unincorporated business are:

- Registration
- Pre-registration input VAT
- Special accounting schemes.

These areas are all covered in detail in Chapter 26.

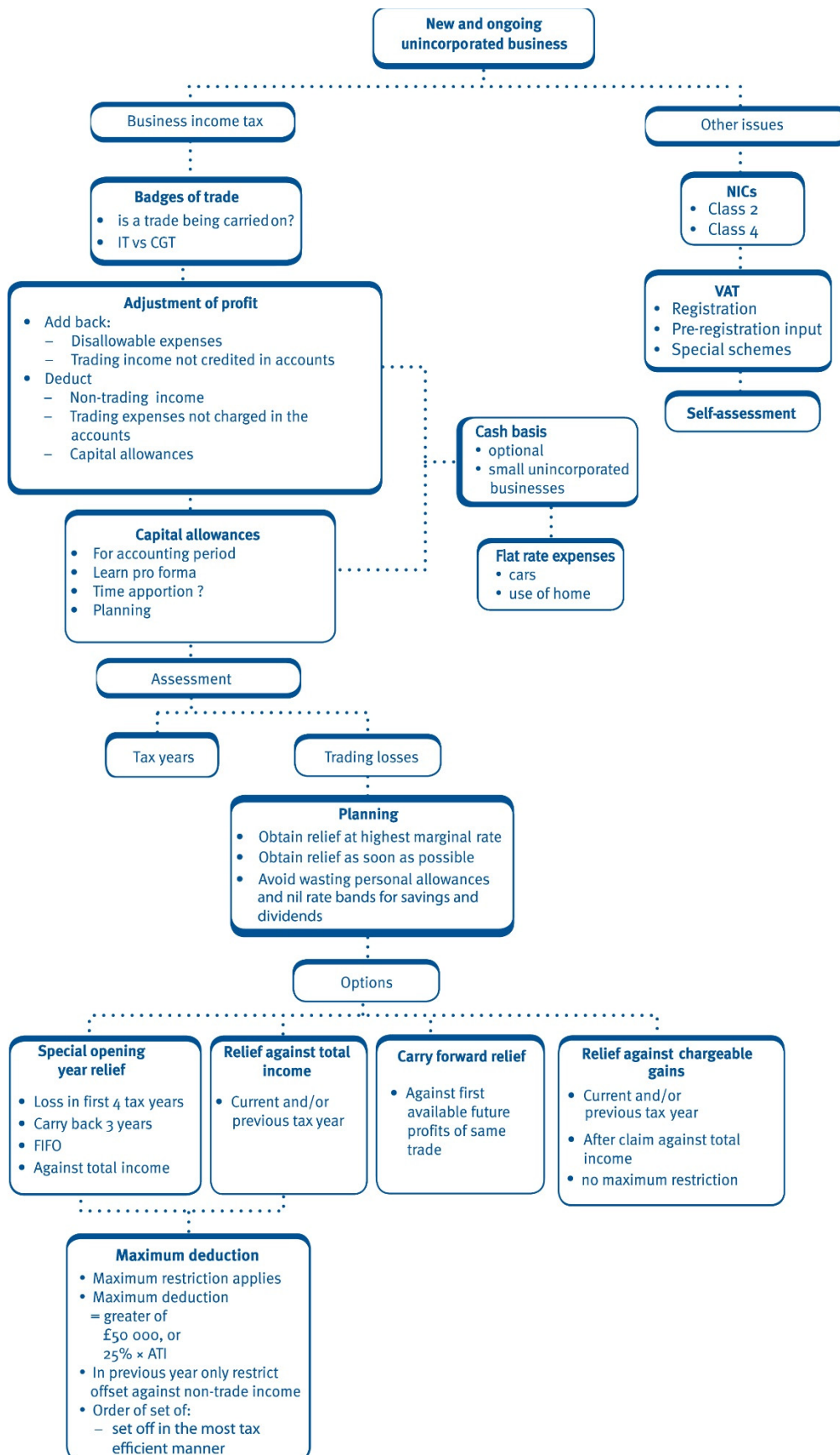
11 Self-assessment

Another important area in examination scenarios is likely to be advising the client on his, her or their duties under self-assessment, particularly:

- Notification of chargeability
- Payment of tax
- Submission of tax returns
- Record keeping.

These areas are all covered in detail in Chapter 15.

12 Chapter summary



Test your understanding answers



Test your understanding 1

Oti

(a) Tax adjusted trading profit – year ended 31 March 2024

	£
Net profit	28,500
Depreciation	2,350
Private accommodation (£1,980 + £5,920 = £7,900 × 30%)	2,370
Motor expenses (£4,700 × 12,000/20,000)	2,820
Fine (Note 1)	220
Donation to political party	100
Excessive salary (Note 3) (£14,000 – £10,500)	3,500
Own consumption (Note 4) (52 × £45)	2,340
Less: Copyright royalties (£150 × 4) (Note 5)	(600)
Capital allowances (Note 6)	(1,200)
	<hr/>
Tax adjusted trading profit	40,400
	<hr/>

Notes:

- (1) Fines are not allowable except for parking fines incurred by an employee.
- (2) Theft is allowable provided it is by an employee rather than the business owner.
- (3) A salary to a family member must not be excessive. Since Oti's daughter is paid £3,500 more than the other sales assistants, this amount is not allowable.
- (4) Goods for own consumption are valued at selling price as no entries have been made in the accounts.
- (5) The copyright royalties have been paid wholly and exclusively for the purposes of the trade and are therefore deductible from trading profits.
- (6) Capital allowances for Oti's car are £3,000 (£16,667 × 18%), with the business proportion being £1,200 (£3,000 × 8,000/20,000).

(b) Income tax computation – 2023/24				
	Non-savings	Savings	Dividend	Total income
	£	£	£	£
Trading income	40,400			40,400
Employment income	10,000			10,000
Building society interest		5,800		5,800
Dividend income			800	800
Total income	50,400	5,800	800	57,000
Less: Loan interest relief (Note 1)	(220)			(220)
Net income	50,180	5,800	800	56,780
Less: PA (Note 1)	(12,570)			(12,570)
Taxable income	37,610	5,800	800	44,210
Income tax				
		£		£
Non-savings income		37,610	× 20%	7,522
SNRB		500	× 0%	0
Savings income		4,590	× 20%	918
Extended basic rate band (Note 2)		42,700		
Savings income		710	× 40%	284
DNRB		800	× 0%	0
		44,210		
Income tax liability				8,724
Less: Tax suffered at source PAYE				(2,000)
Income tax payable				6,724

Notes:

- (1) The loan interest qualifies as a relief deductible from total income since the loan was used by Oti to finance expenditure for a qualifying purpose. It is paid gross.

Both the loan interest and the personal allowance are deducted from income in the most tax efficient manner. In this case, there is no advantage in setting these deductions against dividend income as this would waste the dividend nil rate band. They are therefore deducted from non-savings income.

- (2) The personal pension contribution results in Oti's basic rate tax band threshold being extended to £42,700 (£37,700 + £5,000).

Oti's CGT liability for 2023/24

$$(\text{£}6,900 - \text{£}6,000) \times 20\% = \text{£}180$$

Balancing payment for 2023/24 due on 31 January 2025

$$(\text{£}6,724 + \text{£}180 - \text{£}4,559) = \text{£}2,345$$

Payments on account for 2024/25

Payments on account are not usually required for CGT (unless the disposal is that of a UK residential property), so the payments on account for 2024/25 will be £3,362 (£6,724 × 50%). These will be due on 31 January 2025 and 31 July 2025.

Consequences of paying balancing payment late

- (1) Interest is charged where a balancing payment is paid late. This will run from 1 February 2025 to 30 April 2025.
- (2) The interest charge will be £38 (£2,345 × 6.5% × 3/12).
- (3) In addition, a 5% penalty of £117 (£2,345 at 5%) will be imposed as the balancing payment is not made within one month of the due date.



Test your understanding 2

Gordon

Period ended 31 March 2024

	£
Adjusted profit	349,340
Less: Capital allowances (W)	(253,006)
Trading profit	<u>96,334</u>

Working: Capital allowances computation

	£	Main pool £	Short life asset £	Private use car %	Business use £	Allowances £
Additions:						
Not qualifying for AIA or FYA:						
Car (CO ₂ 48g/km) (Note 1)		10,400				
Private use car (CO ₂ >50g/km)				15,800		
Qualifying for AIA:						
Equipment	300,000		3,250			
AIA (Max) (Note 2)	(250,000)		(0)			250,000
		<u>50,000</u>				
		60,400	3,250	15,800		
WDA (18% × 3/12)		(2,718)	(146)			2,864
WDA (6% × 3/12) (CO ₂ > 50g/km)				(237)	× 60%	142
		<u>57,682</u>	<u>3,104</u>	<u>15,563</u>		
TWDV c/f						
Total allowances						<u>253,006</u>

Notes:

- (1) Private use by an employee is not relevant. A separate private use asset column is only required where there is private use by the owner of the business.
- (2) The AIA is pro-rated for the three-month period. The maximum allowance is therefore £250,000 (£1,000,000 × 3/12). The AIA is allocated to the main plant and machinery in priority to the short life asset.



Test your understanding 3

Jeremy

Step 1 Set up income tax computations before loss reliefs

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Income:	£	£	£	£	£	£
Employment	23,000	23,000	24,000	4,000		
Trading				0	0	16,000
Rental	1,000				1,000	
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total	24,000	23,000	24,000	4,000	1,000	16,000
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

Step 2 Consider use of losses

Using special opening year relief only

- Loss in 2022/23 of £30,000 can be set against total income of 2019/20 – 2021/22 with earliest year first.
- Loss in 2023/24 of £10,000 can be used against total income of 2020/21 – 2022/23.
- No restrictions to preserve PA.

	2019/20	2020/21	2021/22	2022/23
	£	£	£	£
Total income	24,000	23,000	24,000	4,000
2022/23 loss	(24,000)	(6,000)		
2023/24 loss		(10,000)		
	<hr/>	<hr/>	<hr/>	<hr/>
Net income	0	7,000	24,000	4,000
	<hr/>	<hr/>	<hr/>	<hr/>
PA	Wasted	Part wasted		

Alternatively claim standard loss relief against total income and carry forward relief

- Relief can be claimed against total income in the year of the loss and/or the previous year. For the 2022/23 loss, relief is available in 2022/23 and/or 2021/22. There is no point making a claim for 2022/23 as the total income is covered by the PA. Therefore, use £24,000 in 2021/22 and then carry forward £6,000 against trading income of 2024/25.
- The 2023/24 loss can be used in that year and/or 2022/23. In both years the PA is available to cover total income. Therefore, carry forward £10,000 against trading profit of 2024/25. This will still however result in wastage of the PA.

	2021/22	2022/23	2023/24	2024/25
Income:	£	£	£	£
Employment	24,000	4,000	N/A	N/A
Trading	N/A	0	0	16,000
Less: Loss relief b/f				(6,000) (10,000)
Rental			1,000	
	<hr/> 24,000	<hr/> 4,000	<hr/> 1,000	<hr/> 0
Less: Loss relief	(24,000)			
	<hr/> 0	<hr/> 4,000	<hr/> 1,000	<hr/> 0
Net income				
PA	Wasted	Part Wasted	Part Wasted	Wasted

Using special opening year relief relieves the losses immediately as they are carried back. There is a wastage of PA in 2019/20 and partially in 2020/21 but repayments of tax at 20% will result.

Using standard loss relief against total income/carry forward wastes PA in 2021/22 and 2024/25. It does not relieve the loss immediately and tax saved is at 20% tax rates.

Conclusion

On balance, special opening year relief is preferred as the loss is relieved quickly with minimum PA wastage.



Test your understanding 4

Luca

Loss relief offset

	2022/23	2023/24
	£	£
Trade profits	72,000	0
Property income	80,000	80,000
	<hr/>	<hr/>
	152,000	80,000
Less: Loss relief		
Current year claim (restricted) (W1)		(50,000)
– Carry back claim (no restriction against profits from same trade)	(72,000)	
– Balance of loss against other income (not restricted as < £50,000)	(20,000)	
	<hr/>	<hr/>
Net income	60,000	30,000
Less: PA	(12,570)	(12,570)
	<hr/>	<hr/>
Taxable income	47,430	17,430
	<hr/>	<hr/>

Note: The restriction in the tax year 2023/24 is useful as it prevents the wastage of Luca's PA.

Workings

(W1) Maximum loss relief for 2023/24

	£
Total income	80,000
Less: Gross personal pension contributions (£5,000 × 100/80)	(6,250)
	<hr/>
Adjusted total income (ATI)	73,750
	<hr/>
25% thereof	18,438
	<hr/>

Maximum set off will be £50,000 as that is greater than £18,438.

Alternatively, it could be stated that as $ATI < £200,000$, the maximum set off is £50,000.

(W2) Loss memorandum

	£
Loss for 2023/24	142,000
Used 2023/24	(50,000)
Used 2022/23 against profits from the same trade	(72,000)
Used 2022/23 against other income (within maximum £50,000)	(20,000)
	<hr/>
Loss carried forward	0
	<hr/>

Note: If the loss for the tax year 2023/24 were £175,000, relief against non-trading income in the tax year 2022/23 would be restricted to £50,000.

**Test your understanding 5****Rosemarie****(a) Normal accruals basis**

	£
Net profit	11,165
Food, utilities etc.	4,900
Depreciation	2,500
Motor expenses (£4,200 × 30%)	1,260
Other expenses	0
	<hr/>
	19,825
Less: Capital allowances (W1)	(9,806)
	<hr/>
Tax adjusted trading profit	10,019
	<hr/>

Note:

The usual presentation of an adjustment of profits is produced above and must be used where accounts have been prepared and need adjustment.

However, an alternative method of calculating the same tax adjusted trading profit figure is to reproduce the accounts presentation but just deduct the expenses which are allowable, as opposed to adding back to net profit those that are not allowable.

This alternative presentation is given in (W3) as it provides a more direct comparison of the difference in the treatment when the cash basis is used.

(b) Cash basis

	£	£
Revenue (£48,035 – £6,575)		41,460
Less: Food, utilities etc. (£15,670 × 80%)		(12,536)
		<hr/>
Gross profit		28,924
Less: Expenses		
Depreciation (Note 1)	0	
Capital expenditure (Note 1)	(9,000)	
Motor expenses (W2) (Note 2)	(4,750)	
Other expenses (£14,500 – £460)	(14,040)	
Plus: Private use adjustment (Note 3)	4,000	
	<hr/>	(23,790)
		<hr/>
Tax adjusted trading profit		5,134
		<hr/>

Notes:

- (1) Depreciation is not allowable under the cash basis, the cost of the fixtures and fittings is allowable when paid for. The cost of the car is not however allowable, capital allowances are available – but see Note 2.
- (2) Where the flat rate mileage allowance is claimed, capital allowances are not available on the cost of the car. The ATX examining team has stated that where the cash basis is used, you should assume that flat rate expenses will also be claimed.
- (3) The private use adjustment of £4,000 relates to the private element of food and utility costs.

Workings**(W1) Capital allowances**

	£	Main pool £	Private use car £	Allowances £
Additions:				
Car (CO ₂ 48g/km)			9,600	
Fixtures and fittings	9,000			
AIA	(9,000)			9,000
	<hr/>	0		
WDA (18% × 8/12)			(1,152) × 70%	806
		<hr/>	<hr/>	
TWDV c/f		0	8,448	
		<hr/>	<hr/>	
Capital allowances				9,806
				<hr/>

(W2) Motor expenses – cash basis

	£
10,000 × 45p	4,500
1,000 × 25p	250
	<hr/>
	4,750
	<hr/>

(W3) Accruals basis – alternative presentation

	£	£
Revenue		48,035
Less: Food, utilities etc. (£15,670 – £4,900)		(10,770)
		<hr/>
Gross profit		37,265
Less: Expenses		
Depreciation (Note 1)	0	
Motor expenses (£4,200 × 70%)	(2,940)	
Other expenses	(14,500)	
Capital allowances (W1)	(9,806)	
	<hr/>	(27,246)
		<hr/>
Tax adjusted trading profit		10,019
		<hr/>

Note:

This question is for tutorial purposes. In practice it is unlikely that a business would prepare accounts on an accruals basis if they intend to use the cash basis for tax purposes.

Indeed such businesses may not even need an accountant to prepare cash accounts.



Test your understanding 6

James

Class 2 NICs

	£
(£3.45 × 52 weeks)	179
	<hr/>

James' profits for class 4 purposes are as follows:

	£
Taxable trading profits for 2023/24	62,000
Less: Trading losses b/f	(10,000)
	<hr/>

Profits for class 4 purposes	52,000
	<hr/>

Class 4 NICs

	£
(£50,270 – £12,570) × 9%	3,393
(£52,000 – £50,270) × 2%	35
	<hr/>
	3,428
	<hr/>

Celine

Class 2 NICs

(£3.45 × 52 weeks)	179
	<hr/>

Class 4 NICs

(£15,000 – £12,570) × 9%	219
	<hr/>



Test your understanding 7

Henry and Mary

Operating as a sole trader

	£	£	Total tax £
Income tax on profit of £80,000 (PA used by rental income)			
Basic rate band	37,700 @ 20%	7,540	
Higher rate band	42,300 @ 40%	16,920	
	<u>80,000</u>	<u></u>	
			24,460
Income tax liability			
NICs			
Class 2 (52 weeks @ £3.45 per week)			179
Class 4 (£50,270 – £12,570) × 9%		3,393	
(£80,000 – £50,270) × 2%		595	
		<u></u>	<u>3,988</u>
Total tax and NIC liability			<u>28,627</u>

Employing Mary at a gross salary of £30,000 p.a.

	£	£	£
Employer's NICs re Mary payable by Henry			
Class 1 employer's contributions			
(£30,000 – £9,100) × 13.8%			2,884
Less: Employment allowance (Note)			(5,000)
			<u>0</u>

Tax payable by Henry on profits from the business

Profits			80,000	
Adjustment to profits				
Mary's salary			(30,000)	
Employer's NICs			(0)	
			<hr/>	
Tax adjusted profits			50,000	
			<hr/>	
Income tax				
Basic rate band	37,700	@ 20%	7,540	
Higher rate band	12,300	@ 40%	4,920	
	<hr/>			
	50,000			
	<hr/>		<hr/>	
Income tax liability				12,460
NICs				
Class 2 As above				179
Class 4 (£50,000 – £12,570) × 9%				3,369
				<hr/>
				16,008
				<hr/>

Note: The employment allowance of £5,000 to set against the employer's class 1 contributions is available even though Mary is the sole employee. The allowance is only not available if it is a company where a director is the sole employee.

Tax payable by Mary re her salary

As rental income covers her PA, Mary will be subject to tax on £30,000 taxable income (all other income):

	£		£	£
Income tax				
Basic rate band	30,000	@ 20%	6,000	
	<hr/>		<hr/>	
Income tax liability				6,000
NICs				
Employee's class 1 (£30,000 – £12,570) × 12%				2,092
				<hr/>
				8,092
				<hr/>
Total tax and NIC liability (£16,008 + £8,092)				24,100
				<hr/>

Tax saved by employing Mary (£28,627 – £24,100) = £4,527

Running the business in equal partnership with Mary

Both Henry and Mary will be subject to tax on £40,000 (£80,000 × 50%) taxable income (all other income) as follows:

	£		£	£
Income tax on profit of £40,000				
Basic rate band	37,700	@ 20%	7,540	
Higher rate band	2,300	@ 40%	920	
	<u>40,000</u>		<u>8,460</u>	
Income tax liability (£8,460 × 2)				16,920
NICs				
Class 2 (52 weeks @ £3.45 per week) × 2				358
Class 4 (£40,000 – £12,570) × 9%			2,469	
Class 4 NIC liability (£2,469 × 2)				4,938
Total tax and NIC liability				<u>22,216</u>

Tax saved by taking Mary on as equal partner (£28,627 – £22,216) = £6,411

Note: If the examination question asks you to calculate 'total tax', you need to consider all the taxes that will apply (i.e. income tax and NICs in this question).

Cessation of an unincorporated business

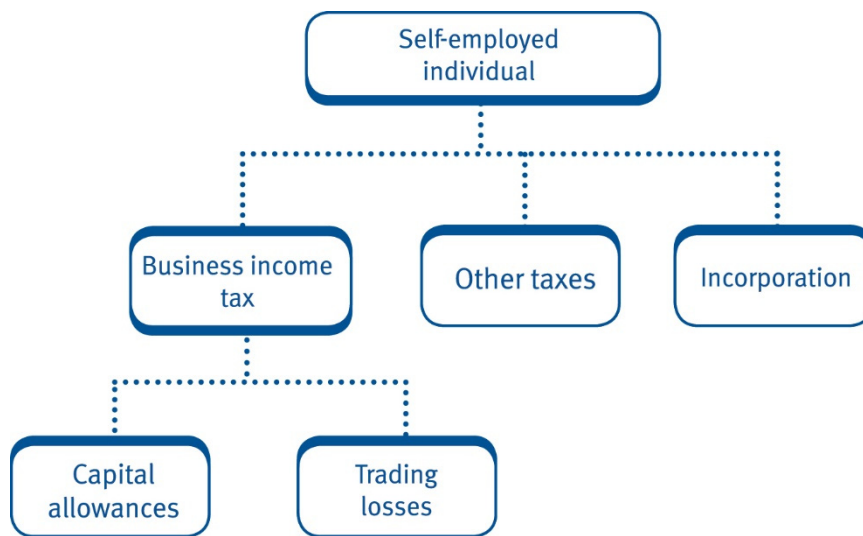
Chapter learning objectives

Upon completion of this chapter you will be able to:

- advise on the relief available for trading losses following the transfer of a business to a company
- understand and apply the relief that is available on the transfer of an unincorporated business to a limited company
- identify and advise on the taxes applicable to a given course of action and their impact
- identify and understand that the alternative ways of achieving personal or business outcomes may lead to different tax consequences
- assess the tax advantages and disadvantages of alternative courses of action
- advise on legitimate tax planning measures, by which the tax liabilities arising from a particular situation or course of action can be mitigated.



One of the PER performance objectives (PO17) is to advise on mitigating and deferring tax liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter covers the popular examination scenario of the cessation of an unincorporated business.

There is scope for a wide variety of questions due to the various ways in which an unincorporated business can cease:

- a sole trader sells the business to another sole trader
- a sole trader gifts the business
- a sole trader retires or dies
- a partner leaves the partnership
- a sole trader sells the business to a company (incorporation).

As in the previous chapter, we need to consider all of the possible tax implications of these scenarios.

The main considerations are as follows:

- income tax issues on cessation
- loss reliefs
- VAT issues on cessation
- capital gains tax issues on cessation
- incorporation of a business.



Many of these concepts you will be familiar with from your TX studies. In ATX these may be tested from an advisory perspective, so a thorough understanding of these topics is vital.

1 A revision of basic business income tax

If the business ceases to trade, the key differences in the calculation of taxable trading profits will be:

- calculating the capital allowances for the final accounting period
- applying the closing year rules for assessment of profits.



For exams in the period 1 June 2024 to 31 March 2025 the closing year rules will **not be tested**.

2 Capital allowances in the closing years

Plant and machinery

The final period of account before cessation is usually not 12 months in length, however there is no need for any time apportionment as:

- there are no WDAs, FYAs, or AIAs in the final period
- all additions are brought in, then disposals on cessation are dealt with
- if an owner takes over an asset, the disposal proceeds will be the market value
- the disposals will give rise to BCs and BAs
- the capital allowances computation is then closed off.



Successions to trade between connected persons

If the business is being transferred

- as a **going concern**
- to a **connected person**
- an **election** is available
- to **transfer the assets at their TWDV** (instead of market value) and thereby avoid BCs and BAs.

If the predecessor and successor to a trade are connected, and the election is made, the approach for capital allowances purposes is broadly to ignore the change of ownership:

- the actual sale price (if any)/transfer value is ignored
- the plant and machinery is deemed to have been sold for the predecessor's **opening written down value**
- consequently, no balancing charge or allowance arises on the predecessor, and no WDAs are claimed in the period of transfer
- the successor uses the same written down value to begin their computation but it is treated as a transfer and not an acquisition

- the successor claims WDA on the TWDV transferred
 - no AIA or FYA is available on this amount to the successor.

To be entitled to this privileged treatment, the following conditions must be satisfied:

- an election must be made jointly by the predecessor and successor within two years of the time the succession took place
- both parties must be within the charge to UK tax on the profits of the trade
- the assets must be in use in the trade immediately before and after the succession.

If no election is made assets are deemed to have been sold at market value as normal, and accordingly:

- balancing adjustments arise on the predecessor
- the successor is treated as having made an acquisition
 - however if the business is being transferred to a connected person, no AIA or FYA is available to the transferee.

The predecessor and successor are connected if:

- they are related to one another (i.e. sibling, ancestor or lineal descendant), are spouses or civil partners, or are related by marriage or civil partnership
- one is a partner and the other has the right to a share in that partnership,
- one is a company and the other has control over it,
- they are both partnerships and another person has the right to share in them both,
- they are both companies (or one company and one partnership) and another person has control of them both.



Test your understanding 1

Julia has been trading as a sole trader since 2013 and has always prepared her accounts to 31 March. Her business is becoming more and more profitable, so she has decided to incorporate at the end of March 2024. She will transfer all her business assets to a new company to be formed, which is to be called Jules Ltd. Julia will be the sole shareholder of Jules Ltd.

The values of her plant and machinery are as follows:

	TWDV b/f at 1 April 2023	MV at 31 March 2024
	£	£
Main pool items	24,000	37,000

After incorporation, Julia will become a director and is the only employee of Jules Ltd. The company will also prepare its accounts to 31 March.

The tax adjusted trading profits of the business are as follows:

	£
Forecast for year ended 31 March 2024 (before capital allowances)	82,550
Forecast for year ended 31 March 2025 (before capital allowances)	85,000

Neither Julia or Jules Ltd will receive any other income besides the trading profits.

Explain the options available with regard to capital allowances. You should consider the effect on both Julia and Jules Ltd, including supporting calculations, and advise on which alternative is best.

Structures and buildings allowances (SBAs)

No balancing adjustment arises on a building on which SBAs have been claimed. In the final period of account SBAs can be claimed until cessation. If this period is not 12 months long then SBAs must be time-apportioned.

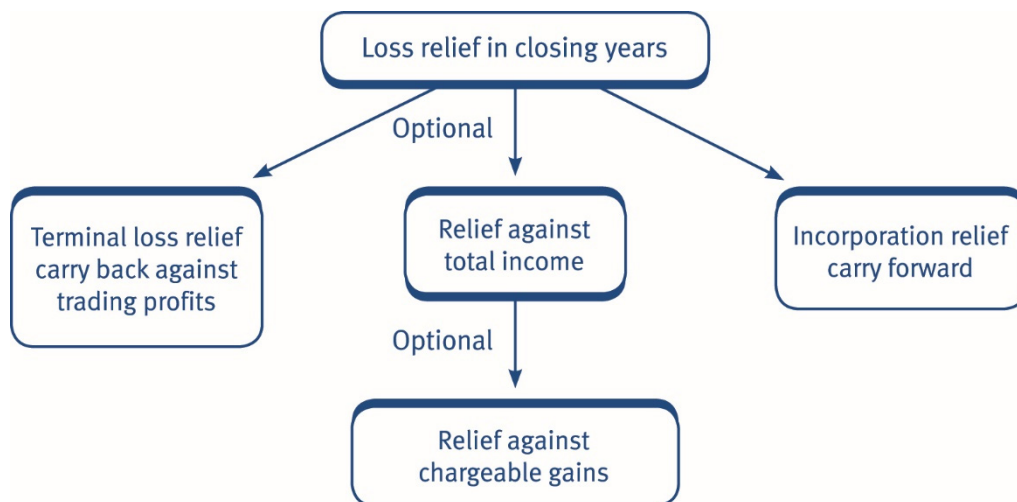
If the business is sold the vendor claims SBAs until the date of disposal. The purchaser can then claim SBAs from this date. SBAs for the purchaser are based on the original cost (to the vendor) and the remainder of the original $33\frac{1}{3}$ year life.

3 Trading losses

Loss relief options in closing years

The options available in the closing years of trade are the same as those available to an ongoing business, except that:

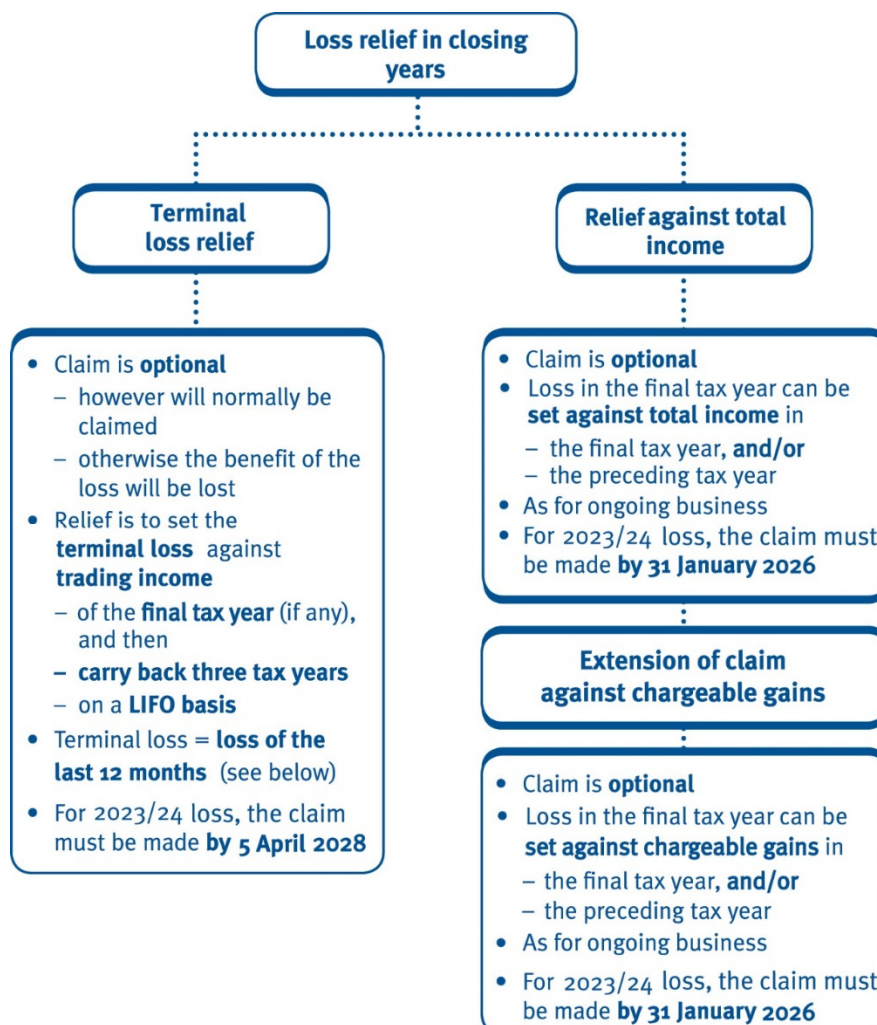
- the option to carry forward losses is not available as there will be no further trading profits once the trade ceases
- an extra option for terminal loss relief is available
- an additional option for incorporation relief is available if the business is ceasing because it is being incorporated.



If an individual makes a trading loss in the closing years, the individual has to decide whether to claim relief against total income and then whether to extend the claim against chargeable gains.

If there are remaining losses, the individual can claim terminal loss relief.

Relief against total income and terminal loss relief



The calculation of the terminal loss

The terminal loss is the loss of the **last 12 months of trading**.



The ATX examining team has confirmed that for exams in the period 1 June 2024 to 31 March 2025 you will not be expected to calculate the amount of a terminal loss.

A question could examine terminal loss relief but if so, the amount of the terminal loss would be provided.

Note that it is not compulsory to make a claim against total income before claiming terminal loss relief.

However, where losses included in the terminal loss have already been relieved under another claim (i.e. against total income or chargeable gains), the amount of the terminal loss must be reduced.



Test your understanding 2

Sergei ceased trading in the tax year 2023/24. His trading results were:

Tax year		£
2020/21	Trading profit	30,000
2021/22	Trading profit	24,000
2022/23	Trading profit	10,000
2023/24	Trading loss = terminal loss	(25,000)

Sergei also had taxable property income each year of £5,000.

Calculate Sergei's taxable income for all tax years assuming relief is claimed in the most beneficial way.

Assume that the tax year 2023/24 rates and allowances apply throughout.



Rules for relief on incorporation

When an unincorporated business ceases, the individual will seek to obtain relief from any losses as soon as possible.

The individual will therefore consider relief against total income and against chargeable gains first, then claim terminal loss relief next. Normally, if there are any unrelieved losses remaining after these claims, the loss is lost.

However, where the business is ceasing due to incorporation, these unrelieved losses can be relieved against future income derived from the company.

The key rules relating to incorporation relief are as follows:

Incorporation relief against future income from the company

- Incorporation relief is available where an unincorporated business
 - is **transferred to a company**
 - **'wholly or mainly'** in exchange **for shares**
- 'Wholly or mainly' is usually taken to mean that **at least 80%** of the consideration received for the business from the company is in the form of shares
- The relief is to **carry the losses forward**
 - indefinitely
 - provided the owner retains the shares throughout the whole tax year in which the loss relief is given, and
 - provided the company continues to carry on the trade of the former unincorporated business
- Losses are **set against**
 - the **first available income** the individual derives **from the company** (e.g. salary, interest, dividends)
 - can set off against types of income from the company in any order
 - most beneficial order will be from employment income first, then savings income, then dividends
- Note that the losses cannot be set against the future profits of the company



Test your understanding 3

On 1 January 2023 Bilal transferred his business that he started on 1 May 2005 to a newly formed limited company, Atkinson Ltd, in exchange for shares. He had incurred trading losses in the opening years and £83,000 remained unrelieved at 1 January 2023.

Bilal owns all the share capital of Atkinson Ltd and plans to draw a salary of £20,000 p.a. from the company and pay himself a dividend of £10,000 in June each year.

His other income comprises dividends of £3,000 p.a. from other UK companies.

Calculate Bilal's net income after reliefs for all relevant years, showing how he will obtain incorporation relief against future income from the company for the losses from his business.

4 Capital gains tax

Whether a sole trader sells a business, gifts a business, incorporates as a going concern or sells off the assets to close the business down, this will represent a disposal for capital gains tax purposes.

Separate gains or losses will be calculated for each chargeable asset of the business, using market value as the proceeds where assets are either given or exchanged for shares in a company.

Typical examples of chargeable assets are:

- Goodwill (provided the business is transferred as a going concern)
- Land and buildings
- Investments

But not:

- Cars
- Plant and machinery falling under the £6,000 chattels exemption
- Plant and machinery sold at a loss (no capital loss if claimed capital allowances).

For basic calculation of chargeable gains/allowable capital losses see Chapters 6 and 7.

Reliefs available

There are a number of reliefs to consider, depending on the scenario:

- Rollover relief
- Gift holdover relief
- Business asset disposal relief
- EIS/SEIS reinvestment relief
- Investors' relief.

All of these reliefs were covered in detail in Chapter 9.

If the business incorporates, then incorporation relief may be available (see section 8).

Gains may also be reduced by:

- capital losses
- the annual exempt amount.

5 VAT

The key issues that may be relevant to a business which is ceasing are:

- deregistration
- transfer of a business as a going concern.

These areas are all covered in detail in Chapter 26.

6 Inheritance tax

If the sale of the business is at an arm's length price, then as there is no diminution in value of the owner's estate there are no IHT implications.

If there is a loss in value to the estate (i.e. the gift of the business or sale at undervalue), then there will be potential IHT implications:

- Gift to an individual – potentially exempt transfer (PET)
- Gift to a trust – chargeable lifetime transfer (CLT)
- Gift to spouse – exempt.

Reliefs

The key IHT relief to consider is business property relief (BPR). See Chapters 10 – 12 for a reminder of the IHT rules.



7 Incorporation

A sole trader or partnership may decide that it would be better to trade through a company, and therefore incorporate the business.

The individual (or partners) may choose to:

- set up a new company for the purpose, or
- transfer the business to an existing company.

Whichever route is chosen, on incorporation, the individual trader (or partners) will own shares in the company which continues the trade of the unincorporated business.

Once the company has been targeted or set up, the assets and trade of the business will be transferred from the personal ownership of the individual to the company.

In most cases the proprietors receive shares in the company equal to the value of the assets transferred.

Note that if it is a new company that is set up with only a few shareholders (e.g. five or fewer shareholders), it is likely to be a close company (see Chapter 24).

Tax implications of transferring a business to a limited company



Transferring the assets to a limited company has the following tax consequences:

Income tax

- The business will cease at the date of the incorporation.
- For capital allowances on plant and machinery, incorporation is treated as an open market value disposal. However, as the trader and the company are connected, they may claim that the assets are transferred to the company at their opening tax written-down value (i.e. make the succession election).

Which method is chosen will depend on whether a market value disposal would produce balancing charges or allowances.

In either situation the company will then claim capital allowances, although no AIA or FYAs (if applicable) would be available.

- The trader will be able to claim SBAs until the date of the transfer. This will reduce trading profits in the final period. The company will then claim SBAs based on original cost and the remainder of the original life.
- Any SBAs claimed will be added to the sales proceeds when calculating any gain on the transfer, unless incorporation relief applies (see section 8). Where incorporation relief applies there is no adjustment at incorporation. Instead, the total SBAs claimed by the trader and the company will be added to the sale proceeds on the eventual disposal by the company.
- If the business had unrelieved losses at the time of the incorporation they can be relieved against future income derived from the company.

National insurance contributions

- As a sole trader the individual will have paid class 2 & 4 NICs.
- As a director/employee of the company the individual will have to pay employee class 1 NICs.
- The company also pays employer's class 1 NICs in respect of any cash earnings paid to employees and class 1A NICs if benefits are provided.

The company would not be able to deduct the employment allowance if the individual is the sole director of the company earning over £9,100.

Capital gains tax

- The assets of the business are treated as being sold to the company for their market value.
- There are two main ways in which relief can be given in respect of gains on incorporation depending on how the transaction is arranged:
 - incorporation relief, or
 - gift holdover relief

These reliefs are considered in detail in section 8.

VAT

- Providing the company is registered for VAT the transfer of assets will be a transfer of a going concern, and so not a taxable supply.
- For ease of administration the company may take over the trader's VAT registration.

Stamp duty land tax

- Where there is a property involved, SDLT will be payable by the company, assuming the property is worth in excess of the SDLT threshold.
- This charge can be avoided by not transferring the property to the company, however CGT incorporation relief would not then be available (as it requires all assets to be transferred).
- In this case, the relevant assets could be gifted to the company, and a claim made to defer the gain under the gift holdover relief provisions.

Corporation tax

- It is probable that the company will be a close company, and the implications of this are discussed in Chapter 24.

Inheritance tax

- There should be no IHT implications, as there is no gratuitous intent involved in an incorporation.
- Furthermore, the individual still owns the assets from the unincorporated business but through a company, so there should be no fall in value in the individual's estate.
- Consideration should be given as to the availability of BPR in the future. An unincorporated trading business is usually eligible for 100% BPR. However, going forward the individual will now own shares which may, or may not, be eligible for BPR.

Summary

Tax	Considerations
Income tax	Cessation of business Capital allowances and disposal value Trading losses
NIC	Change from classes 2 and 4 to class 1
CGT	Disposal at open market value Methods of deferring gain until later disposal Possible loss of BADR on goodwill
VAT	Transfer of going concern
SDLT	Company liable if property transferred
CT	Company will probably be a close company
IHT	No IHT charge But watch out for BPR availability in future



8 Incorporation relief

Where an individual transfers an unincorporated business (i.e. a sole trader business or a partnership) to a company, the individual assets of the business are deemed to have been disposed of at market value to the company.

Incorporation relief is available to allow the gains arising on incorporation to be deferred until the shares in the company are disposed of.

The operation of the relief

Incorporation relief operates as follows:

- The total net chargeable gains arising on the deemed disposal of the individual assets are aggregated.
- The total net chargeable gains are deferred against the deemed acquisition cost of the shares in the company (i.e. deducted from the base cost of the shares).
- BADR on the subsequent disposal of shares is based on the qualifying conditions (see Chapter 9).
- The relief is automatic provided certain conditions are met.

Conditions for the relief

All of the following conditions must be satisfied:

- The unincorporated business is transferred as a going concern.
- All of the assets of the business (other than cash) are transferred to a company (new or existing).
- The consideration received for the transfer of the business must be received wholly or partly in the form of shares in the company.

Where all of these conditions are met the relief is **automatic**.

The calculation of the incorporation relief

The amount of the 'total gains' arising on incorporation that can be deferred depends on whether the transfer is wholly or partly for shares.

Transfer wholly for shares

Where the consideration for the transfer of the business to the company is wholly shares:

- the total net gains on the individual chargeable assets transferred to the company are deferred
- no chargeable gain arises at the time of the incorporation
- the base cost of the shares acquired = the market value of the unincorporated business less the deferred gains.

Transfer partly for shares

Where part of the consideration for the transfer of the business is not in the form of shares (for example, cash and/or loan notes):

- incorporation relief

$$= \text{Total gains} \times \frac{\text{Market value of share consideration}}{\text{Market value of total consideration}}$$

- gain becomes chargeable at the time of incorporation

$$= \text{Total gains} \times \frac{\text{Market value of non-share consideration}}{\text{Market value of total consideration}}$$

Note that:

- cannot make a partial claim to defer only some of the gain
- however, the individual could choose to accept some cash or other non-share consideration to ensure that incorporation relief will leave a gain to be taxed which utilises any capital losses and AEA available.

Disapplying incorporation relief

- An individual can elect for incorporation relief not to apply (i.e. disapply the relief).
- This election may be useful if:
 - the gains on incorporation would be covered by the AEA and/or capital losses, or
 - it would be beneficial to take advantage of BADR at the time of the transfer which may not be available on the eventual disposal of shares (see below).
- The election to disapply the incorporation relief rules must be made by 31 January 2027 for an incorporation that takes place in the tax year 2023/24.
- However, if the shares received are sold by the end of the tax year following the tax year of incorporation, this deadline is brought forward by one year (i.e. to 31 January 2026 for incorporation in the tax year 2023/24 with sale of shares during the tax year 2024/25).

Interaction with business asset disposal relief

If applicable, incorporation relief is given **before** considering BADR. If the transaction is wholly for shares there will be no gain, and therefore, BADR is not considered.

If full relief is not available using incorporation relief (e.g. if part of the consideration is in the form of cash), any remaining gain (with the possible exception of goodwill – see below) will usually qualify for BADR as it relates to the disposal of an unincorporated business, provided the business has been owned for at least two years before incorporation. The chargeable gain after incorporation relief will therefore be taxed at 10%.



Rate of CGT – tax planning

It is important to note that:

- The subsequent disposal of the shares acquired at the time of incorporation should normally qualify for BADR and any gain arising will be taxed at 0% or 10% depending on the availability of capital losses and the AEA, provided the conditions for BADR are satisfied (i.e. the individual owns at least 5% of the shares and is an employee, for the two-year qualifying period).

Remember that the period of ownership of the unincorporated business prior to incorporation will count towards the two-year qualifying ownership period of the shares where a business has been transferred as a going concern together with all of the assets (except cash) in exchange wholly or partly for shares, as set out in Chapter 9.

- However, if BADR is not likely to be available on the disposal of the shares, the individual may **choose to disapply** incorporation relief in order to crystallise a gain on incorporation so that BADR can be claimed now.

Note that gains in respect of goodwill may not qualify for BADR where the business is transferred to a close company (see Chapter 24).

The circumstances in which gains in respect of goodwill will qualify for BADR are covered in Chapter 9.



Illustration 1 – Incorporation relief

Yun, a higher rate taxpayer, bought a travel agency in Cornwall in August 2020 paying £11,500 for the goodwill.

On 15 July 2023 she sold the business as a going concern to Kareol Ltd, a large existing company, which took over all of the assets, except for cash, at the following agreed values:

	£
Freehold premises (cost £179,000 in September 2021)	284,000
Goodwill	44,000
Estate car	6,000
Inventory and receivables	6,000
	<hr/>
	340,000
	<hr/>

The consideration for the sale was settled by Kareol Ltd allotting to Yun 70,000 ordinary shares of 20p each, valued at 350p per share, and paying her cash of £95,000. The shares are not quoted and represent a 3% shareholding in Kareol Ltd.

On 25 March 2024 Yun sold 10,000 ordinary shares in Kareol Ltd for £45,000 to an unconnected person. On the same day Yun gave a further 10,000 shares in Kareol Ltd to her daughter.

Calculate the CGT payable by Yun as a result of the above disposals, assuming all available reliefs are claimed (where necessary).

Solution**Capital gains tax computation – 2023/24**

	£	£
Gains not qualifying for BADR		
Sale of Kareol Ltd shares (W2)		24,154
Gift of Kareol Ltd shares (W3)		0
Gains qualifying for BADR		
Transfer of business to Kareol Ltd (W1)	38,419	
	<hr/>	<hr/>
Chargeable gains	38,419	24,154
Less: AEA (Note 1)		(6,000)
	<hr/>	<hr/>
Taxable gains	38,419	18,154
	<hr/>	<hr/>
Capital gains tax:	£	£
Qualifying gains	38,419 × 10%	3,842
Non-qualifying gains (Note 2)	18,154 × 20%	3,631
		<hr/>
		7,473
		<hr/>

Notes:

- (1) The AEA is set against gains not qualifying for BADR.
- (2) After the gains qualifying for BADR have been taxed at 10%, any remaining qualifying gains are taxed at the appropriate rate depending on the taxpayer's level of income.

Workings**(W1) Transfer of business to Kareol Ltd – July 2023**

	£	£
Freehold premises		
Deemed proceeds (MV)	284,000	
Less: Cost	(179,000)	
	<hr/>	105,000
Goodwill		
Deemed proceeds (MV)	44,000	
Less: Cost	(11,500)	
	<hr/>	32,500
Estate car/inventory and receivables (exempt assets)		0
		<hr/>
Total gains before reliefs		137,500
Less: Incorporation relief		
£137,500 × (£245,000/£340,000)		(99,081)
		<hr/>
Gains qualifying for BADR		38,419
		<hr/>

Notes:

- (1) Incorporation relief is given automatically and does not need to be claimed.
- (2) Even if Kareol Ltd was a close company, the proportion of the remaining gain relating to goodwill would still qualify for BADR as Yun's shareholding in Kareol Ltd is less than 5%.

(W2) Sale of 10,000 Kareol Ltd shares

	£	£
Sale proceeds		45,000
Shares acquired (July 2023)		
(70,000 × £3.50)	245,000	
Less: Incorporation relief	(99,081)	
	<hr/>	
Base cost of total shareholding	145,919	
Deemed cost of sale of 10,000 shares:		
(£145,919 × 10,000/70,000)	(20,846)	(20,846)
	<hr/>	
Deemed base cost of remaining shares	125,073	
	<hr/>	
Chargeable gain		24,154
		<hr/>

Note: Yun's combined ownership of the business and the shares is more than two years. However, as Yun owned < 5% of the shares in Kareol Ltd, BADR is not available.

Had she owned 5% and worked for Kareol Ltd, the gain on the shares would qualify for BADR.

(W3) Gift of 10,000 Kareol Ltd shares

	£
Capital gain (computed as above)	24,154
Less: Gift holdover relief (Note)	(24,154)
	<hr/>
Chargeable gain	0
	<hr/>

Note: The gift of unquoted trading company shares is an outright gift of qualifying shares for gift holdover relief purposes. The base cost of the daughter's shares will be £20,846 (£45,000 – £24,154).



Test your understanding 4

On 31 January 2024, Saanvi sold her business to a limited company for an agreed value of £1,100,000. She set up the business in August 2012.

All of the assets were transferred to the company with the exception of the cash.

The assets transferred were as follows:

	Date of Purchase	Market value 31 January 2024	Cost
		£	£
Freehold premises	August 2012	700,000	240,000
Goodwill	—	250,000	—
Inventory & receivables	—	150,000	—
		<hr/>	
		1,100,000	
		<hr/>	

(a) Calculate the gain immediately chargeable and the base cost of these shares assuming Saanvi received:

- (i) 100,000 £1 ordinary shares in the company.**
- (ii) 80,000 £1 ordinary shares plus £220,000 in cash.**

(b) State the tax planning advice you would give to Saanvi.

Alternative deferral using the gift holdover relief provisions

One of the disadvantages of incorporation relief is that all of the assets (except cash) must be transferred to the company.

It is common for the trader to want to retain land and buildings. This avoids a stamp duty land tax charge and gives the trader the ability to extract funds from the company by renting the premises to the company (although this would restrict any BADR on a subsequent sale of the premises).

However, if the trader wishes to retain any assets of the business other than cash, incorporation relief is denied and significant gains may crystallise on incorporation.

As an alternative to incorporation relief, the trader may use gift holdover relief to defer gains against the base cost of the assets for the company.

As a first step, any non-chargeable assets such as inventory and receivables should be transferred to the company in exchange for shares. There will be no gains on these assets, and the 'cost' of the shares will be the market value of these assets.

Then the goodwill and any other chargeable assets are gifted to the company. Gains will arise but will be deferred against the base cost of the assets in the hands of the company.

The disadvantages of using this method are:

- it gives the company lower base costs for the assets than if incorporation relief were used, which will lead to higher gains or profits arising in the company on the future disposal of these assets
- the shares still have a fairly low base cost, so there will be a larger gain on the eventual disposal of the shares.



Test your understanding 5

On 31 August 2023, Lars transferred his business to a limited company. He set up the business in August 2012.

All of the assets were transferred to the company with the exception of the freehold premises which Lars kept in his own name.

The assets transferred were as follows:

	Market value 31 August 2023	Gains
	£	£
Goodwill	300,000	300,000
Inventory & receivables	100,000	—
	<hr/>	<hr/>
	400,000	300,000
	<hr/>	<hr/>

Explain how gift holdover relief can be used to shelter the gain on the goodwill and calculate the base cost of the shares.

**Test your understanding 6**

Isaac has owned a trading business for three years, and is considering transferring the business to Plum Ltd in exchange for 500 shares in the company (there are 50,000 shares in issue).

Isaac will be an employee of the company after the transfer.

The gains before reliefs would be as follows:

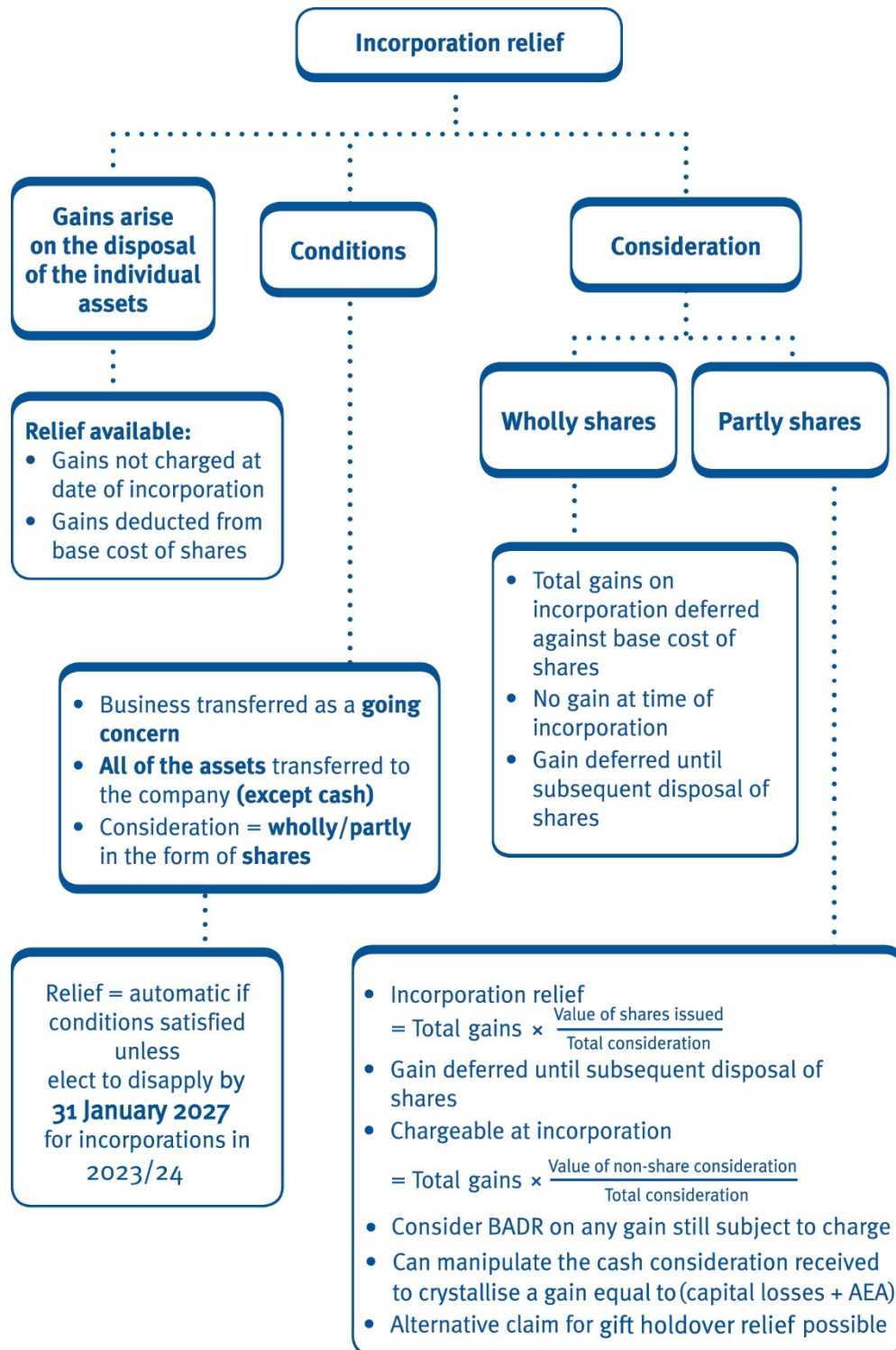
Goodwill	£50,000
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Freehold building	£80,000 (built in 2016)
-------------------	-------------------------

It is anticipated that the property will increase in value by 50% in the next two years at which time it is likely to be sold and larger premises will then be rented.

Consider the alternative courses of action available to achieve the transfer of the business and explain any immediate and future taxation impact including any advantages and disadvantages.

Summary



9 Comprehensive example



Test your understanding 7

Marwa has been trading for a number of years, but at the age of 55 decides that the time has come to retire, and sells the business.

She ceases trading on 31 March 2024, and has the following adjusted profit for her final accounting period:

Nine months ended 31 March 2024 (before deducting capital allowances)	£35,187
--	---------

The TWDVs at 1 July 2023 for capital allowances are:

	£
Main pool	15,637
Car (private use 40%)	12,700

No assets were purchased during the final accounting period, and on 31 March 2024 all assets in the pool were sold for £13,255, none for more than the original cost. Marwa decided to keep the car, which was worth £13,000.

The following information is also available regarding the sale of the business on 31 March 2024:

Value of office	£170,000
Cost of office (January 1999)	£35,000
Value of goodwill	£200,000

- (a) **Calculate Marwa's adjusted profit after capital allowances for the period ended 31 March 2024.**
- (b)
 - (i) **Calculate the capital gains tax payable on the sale of the business.**
 - (ii) **Explain the capital gains tax and inheritance tax implications if Marwa were to give the business to her son instead.**

- (c) Marwa has just received an offer from Jumbo plc to purchase her business for £400,000 broken down as follows:

	£
Office	170,000
Plant and machinery	13,255
Car	13,000
Net current assets	3,745
Goodwill	200,000
	<hr/>
Market value of the business	400,000
	<hr/>

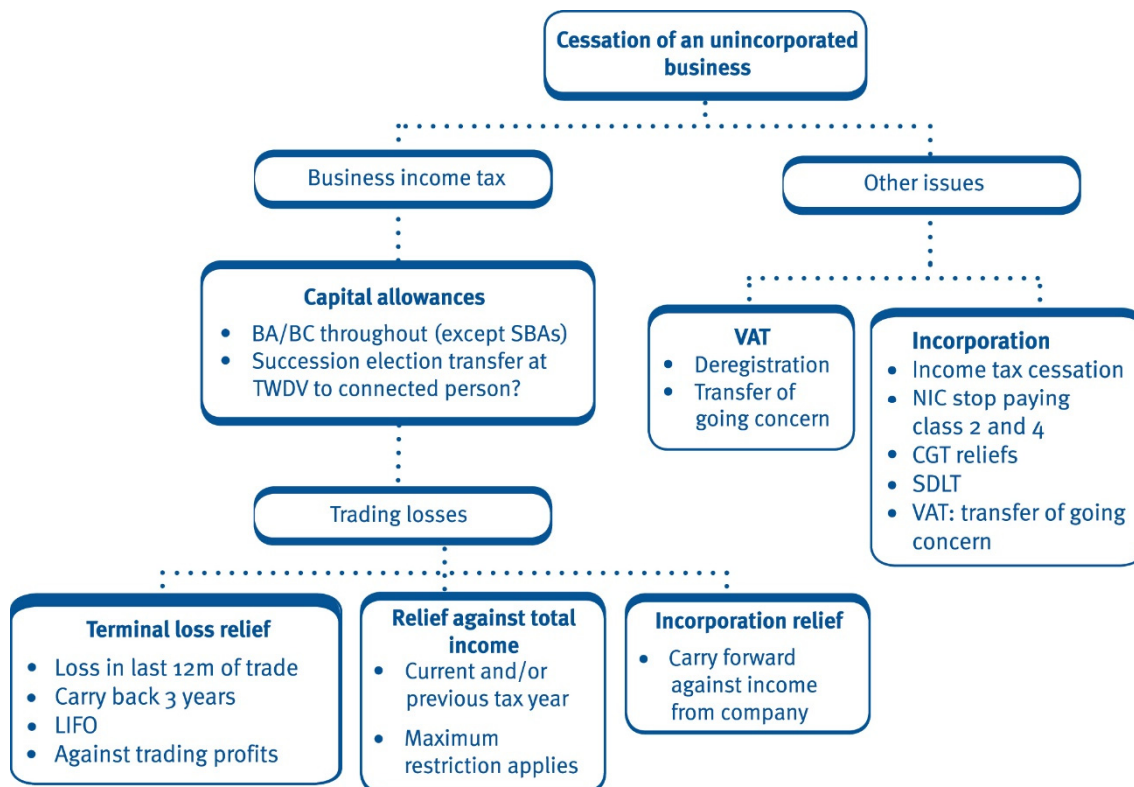
Marwa would receive £150,000 in cash and £250,000 worth of shares in Jumbo plc. Marwa would hold a 1% interest in Jumbo plc.

Assume plant and machinery is sold at less than cost.

Calculate the CGT payable, assuming that all available reliefs are applied.

Assume the 2023/24 rates and allowances apply throughout.

10 Chapter summary



Test your understanding answers



Test your understanding 1

Julia

Capital allowances on incorporation

When Julia incorporates her business she has two options regarding capital allowances:

(1) Option 1 – normal cessation of a business rules

Balancing adjustments will arise in the final sole trader capital allowance computations. The adjustments are calculated by reference to the MV of the pool assets on incorporation (restricted to cost if lower), compared to the TWDV at that date.

The company can then claim an 18% WDA, on the reducing balance basis, based on the MV of the assets acquired. Note however that the AIA is not available on these assets, as they are acquired from a connected party.

If the business is incorporated on 31 March 2024, the taxable balancing charges will arise as follows:

	Main pool £	Allowances/ (charges) £
TWDV b/f	24,000	
Disposal at MV	(37,000)	
	<hr/>	
Balancing charge	(13,000)	(13,000)
	<hr/>	<hr/>

The allowances available to the company in the y/e 31 March 2025 will be:

	Main pool £	Allowances/ (charges) £
Acquisition at MV	37,000	
WDA (18%)	(6,660)	6,660
	<hr/>	
TWDV c/f	30,340	
	<hr/>	<hr/>
Total allowances		6,660
		<hr/>

(2) Option 2 – succession election

An election (known as the succession election) can be made for the assets in the main pool to be transferred to the company, Jules Ltd, at TWDV rather than the MV at the date of incorporation.

This is because the trade has passed between connected persons.

As a result, no balancing adjustments arise on the unincorporated business.

The company can then claim an 18% WDA, on the reducing balance basis, based on the TWDV of the assets acquired.

The allowances available to the company in the year ended 31 March 2025 will be:

	Main pool £	Allowances/ (charges) £
Transfer at TWDV	24,000	
WDA (18%)	(4,320)	4,320
	<hr/>	
TWDV c/f	19,680	
	<hr/>	<hr/>
Total allowances		4,320
		<hr/>

Note: Where a succession election is made, the assets are deemed to be transferred to the company at their TWDV at the end of the penultimate period of account.

There are no capital allowances available to Julia in the final period of account.

Recommendation

The succession election will be beneficial to Julia as:

- Without the election, the balancing charges of £13,000 would have the effect of increasing Julia's taxable trading profits. This would be avoided if the succession election is taken.
- Given her current level of profits, avoiding the increase in profits caused by the balancing charge would save income tax at 40% and class 4 NICs at 2%.
- The total saving by Julia would be £5,460 (£13,000 × 42%).

- However, the company would be able to claim £2,340 (£6,660 – £4,320) less capital allowances in the year ended 31 March 2025.
- Given the level projected profits of the business, the company would be in the marginal band and this would result in an increase in corporation tax payable of £620 (£2,340 × 26.5%).
- The net tax saving if the succession election is made would be £4,840 (£5,460 – £620).

For this reason it would appear that a succession election would be beneficial to Julia.

The succession election will need to be made by 31 March 2026 (i.e. within two years of the date of incorporation).



Test your understanding 2

Sergei

Calculation of taxable income

Sergei should claim terminal loss relief (TLR) as follows:

	2020/21	2021/22	2022/23	2023/24
	£	£	£	£
Trading income	30,000	24,000	10,000	0
Less: TLR	–	(15,000)	(10,000)	(0)
Property income	5,000	5,000	5,000	5,000
	<hr/>	<hr/>	<hr/>	<hr/>
	35,000	14,000	5,000	5,000
Less: PA	(12,570)	(12,570)	(5,000)	(5,000)
	<hr/>	<hr/>	<hr/>	<hr/>
Taxable income	22,430	1,430	0	0
	<hr/>	<hr/>	<hr/>	<hr/>

Notes:

Alternatively, relief could be claimed for part of the loss against total income before the PA for the tax year 2023/24 and/or 2022/23, but this would not be beneficial as the total income in 2023/24 is fully covered by the PA in any case.

If a claim was made to set the loss against total income for the tax year 2022/23, £15,000 would be offset (rather than £10,000 with the TLR claim) and all of the PA would be wasted.



Test your understanding 3

Bilal

	2022/23	2023/24	2024/25	2025/26
	£	£	£	£
Employment income	5,000	20,000	20,000	20,000
Less: Loss relief	(5,000)	(20,000)	(20,000)	(18,000)
Atkinson dividend	–	10,000	10,000	10,000
Less: Loss relief		(10,000)	(10,000)	
Other dividends	3,000	3,000	3,000	3,000
	<hr/>	<hr/>	<hr/>	<hr/>
Net income	3,000	3,000	3,000	15,000
	<hr/>	<hr/>	<hr/>	<hr/>
Loss working				£
Unrelieved losses b/f				83,000
Less: Incorporation relief				
2022/23				(5,000)
2023/24				(30,000)
2024/25				(30,000)
2025/26 (balance of loss)				(18,000)
				<hr/>
				0
				<hr/>



Test your understanding 4

Saanvi

(a) (i) Chargeable gain on disposal of business – 2023/24

	£	£
Premises: Proceeds	700,000	
Less: Cost	(240,000)	
	<hr/>	460,000
Goodwill: Proceeds	250,000	
Less: Cost	0	
	<hr/>	250,000
Total capital gains before reliefs		710,000
Less: Incorporation relief		(710,000)
		<hr/>
Chargeable gain – 2023/24		0
		<hr/>
Base cost of shares		
Market value of assets transferred		1,100,000
Less: Incorporation relief		(710,000)
		<hr/>
Base cost		390,000
		<hr/>

BADR is delayed until a subsequent disposal of the shareholding provided the conditions are satisfied.

(ii) Chargeable gain on disposal of business – 2023/24

	£	£
Total capital gains before reliefs (as above)		710,000
Total consideration		
Cash	220,000	
Shares (balance)	880,000	
	<hr/>	
	1,100,000	
	<hr/>	
Less: Incorporation relief (deferred gain) (£710,000 × £880,000/£1,100,000)		(568,000)
		<hr/>
Gain qualifying for BADR		142,000
		<hr/>
Base cost of shares		
MV of share consideration		880,000
Less: Incorporation relief		(568,000)
		<hr/>
Base cost of shares		312,000
		<hr/>

BADR is delayed until a subsequent disposal of the shareholding provided the conditions are satisfied.

(b) Tax advice for Saanvi

Assuming Saanvi has no other capital gains in the year, Saanvi should consider accepting non-share consideration (e.g. cash) to the value that would give rise to a chargeable gain which is covered by her AEA.

	£
Gain required	6,000
The deferred gains should be (£710,000 – £6,000)	704,000
Therefore, the market value of the shares should be: £704,000 = MV of shares × (£710,000/£1,100,000)	
MV of shares	1,090,704
Therefore, the cash should be: (£1,100,000 – £1,090,704)	9,296
	<hr/>

Alternative calculation:

$$\frac{\text{Cash}}{\text{MV of business}} \times \text{Total net gains} = (\text{AEA} + \text{capital losses b/f})$$

$$\frac{\text{Cash}}{\text{£1,100,000}} \times \text{£710,000} = \text{£6,000}$$

$$\text{Cash} = \text{£9,296}$$

Proof:

	£
Capital gain before reliefs	710,000
Less: Incorporation relief	
$\text{£710,000} \times \frac{\text{£1,090,704}}{\text{£1,100,000}}$	(704,000)
Chargeable gain:	<hr/>
Less: AEA	6,000
	(6,000)
	<hr/>
Taxable gain	0
	<hr/>



Test your understanding 5

Lars

The inventory and receivables will be transferred to the company in return for shares.

The shares take on a base cost equal to the MV of these assets, i.e. £100,000.

The goodwill is gifted to the company which results in a gain of £300,000.

Incorporation relief is not available as Lars did not transfer all of the assets to the company.

The £300,000 gain can be reduced to £Nil if a gift holdover relief claim is made.

This will defer the gain and the company will now have a base cost of £Nil for the goodwill.



Test your understanding 6

Isaac

- As Isaac is transferring the whole business the gains will be automatically deferred against any share consideration he receives under incorporation relief.
- On a future disposal of the shares the CGT base cost (the market value of the shares at incorporation) will be reduced by the gains now deferred.
- Business asset disposal relief (BADR) will not be available on a future disposal of the shares. This is only if Isaac owns $\geq 5\%$, is an employee of the limited company, and satisfies the two-year ownership period. Isaac will only own 1% of the shares, therefore will not qualify for BADR.
- As Isaac is not entitled to BADR on disposal of the shares any gain arising will be taxed at 10% or 20%, depending on the amount of Isaac's basic rate band remaining.
- Isaac could consider disapplying incorporation relief with the effect that the gain of:
 - £80,000 relating to the freehold property will qualify for BADR and will be taxed at 10%
 - £50,000 relating to goodwill will also qualify for BADR as although the goodwill is transferred to a close company, Isaac owns less than 5% of the shares.

The total CGT payable immediately would be £12,400 (W).

To disapply incorporation relief, an election must be made.

- Isaac could consider incorporating the business and receive consideration in the form of a mix of shares and loan account/cash. As a result, part of the gain is automatically chargeable on incorporation. With planning, the amount of cash consideration to take can be calculated to ensure the maximum use of any capital losses and the AEA.
- A more long-term disadvantage of using incorporation relief is the fact that the property is transferred to the company. If the property continues to appreciate in value significantly, then on a sale by the company there will be an element of double taxation:
 - a corporation tax charge on the company, and
 - in extracting the profits, a further income tax charge on the individual.

- If Isaac were to keep the property in personal ownership any subsequent disposal would not qualify for BADR as it would not meet the definition of an associated disposal (the shares would not qualify for BADR themselves so are not a 'material disposal')

In addition, incorporation relief would not then be available to defer the gain on the goodwill as Isaac is not transferring all business assets to the company. However, BADR would be available on that gain as the transfer is following the cessation of trade. This gain would then be taxed at 10% or 20% as discussed previously.
- An alternative would be to gift the goodwill (and other non-capital assets as relevant) to the company and claim gift holdover relief to defer the gain on goodwill so enabling the retention of the property outside the company.

Note that the company would not be able to claim relief for the cost of the goodwill for corporation tax purposes (see intangible assets in Chapter 2).

Working: Chargeable gain

	Qualifying for BADR
	£
Gains on incorporation	
Freehold building	
Goodwill	80,000
Less: AEA	50,000
	(6,000)
Taxable gains	<u>124,000</u>
CGT	
On qualifying gains (£124,000 × 10%)	<u>12,400</u>



Test your understanding 7

Marwa

(a) Capital allowances computation – 9 m/e 31 March 2024

	Main pool	Private use car (B.U. 60%)	Allowances
	£	£	£
TWDV b/f	15,637	12,700	
Disposal	(13,255)	(13,000)	
	<hr/>	<hr/>	
	2,382	(300)	
Balancing allowance	(2,382)		2,382
Balancing charge		(300)	60% (180)
	<hr/>	<hr/>	
TWDV c/f	0	0	
	<hr/>	<hr/>	<hr/>
Total allowances			2,202
			<hr/>

The capital allowances are then deducted from the profit for the nine months ending 31 March 2024.

	£
Adjusted profit before capital allowances	35,187
Less: Capital allowances (W)	(2,202)
	<hr/>
Adjusted profit for accounting period	32,985
	<hr/>

As the building was completed before 29 October 2018 no SBAs would be available to be claimed.

(b) (i) Capital gains tax payable on sale of the business

Gains will arise only on the office and the goodwill as follows:

	£	£
Office		
Proceeds	170,000	
Less: Cost	(35,000)	
	<hr/>	135,000
Goodwill		
Proceeds	200,000	
Less: Cost	(0)	
	<hr/>	200,000
		<hr/>
Chargeable gains – qualifying for BADR		335,000
Less: AEA		(6,000)
		<hr/>
Taxable gains		329,000
		<hr/>
CGT payable (£329,000 × 10%)		32,900
		<hr/>

Note: BADR is available on the gain relating to goodwill as the business is not being transferred to a close company of which Marwa is a 5% shareholder.

If SBAs had been claimed on the building these would be added to the sales proceeds for this and increase the gain on transfer.

(ii) Capital gains tax and inheritance tax implications of gift of business**Capital gains tax**

- The assets would be deemed to be sold at market value.
- Gains would arise as above.
- However, Marwa and her son could jointly claim gift holdover relief to defer the gains.
- The gains would then be deducted from the cost of the assets for Marwa's son, giving him bigger gains on the eventual sale.

Inheritance tax

- The gift of the business would be a PET.
- There would be no IHT payable during lifetime.
- The gift would only become chargeable if Marwa were to die within seven years.
- As Marwa would be giving a whole business which she has owned for more than two years, 100% BPR would be available, leaving no IHT to pay.
- However, if Marwa's son sold the business before Marwa's death, the BPR would be withdrawn.

(c) CGT on transfer of business to Jumbo plc

Again, the assets would be deemed to be sold for their market values and gains would arise on the chargeable assets as before.

As the business would be transferred to a company as a going concern, in exchange partly for shares, incorporation relief would automatically apply.

A proportion of the gain before BADR would be deferred until the shares were sold.

	£
Total gains before reliefs (as above)	335,000
Less: Incorporation relief:	
Gains × $\frac{\text{Value of share consideration}}{\text{Total consideration}}$	
£335,000 × (£250,000/£400,000)	(209,375)
	<hr/>
Chargeable gains – qualifying for BADR	125,625
Less: AEA	(6,000)
	<hr/>
Taxable gains	119,625
	<hr/>
CGT payable (£119,625 × 10%)	11,963
	<hr/>

Partnerships: Income tax and capital gains tax

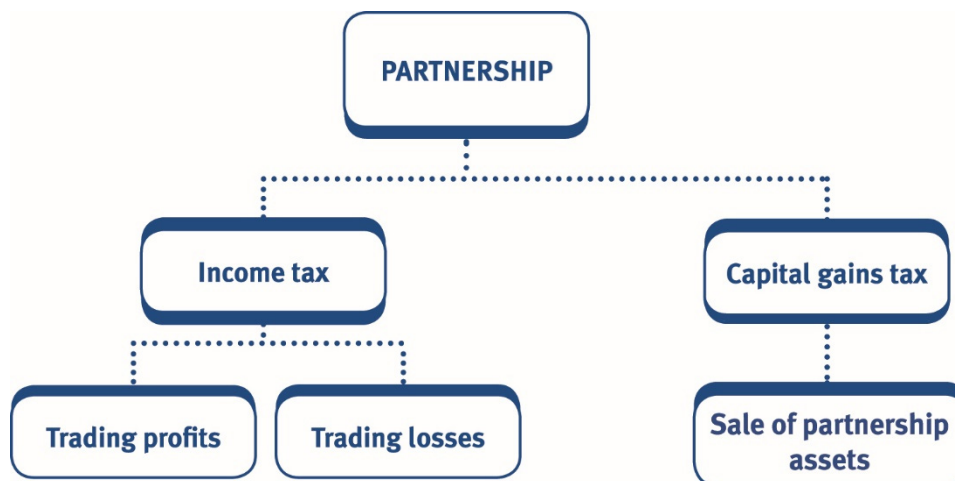
Chapter learning objectives

Upon completion of this chapter you will be able to:

- explain how a partnership is assessed to tax
- show the allocation of trading profits/losses between partners for the accounting period in a variety of business scenarios
- describe the alternative loss relief claims that are available to partners
- identify the occasions when a chargeable gain would arise on a partner in a partnership on the disposal of a partnership asset.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.



Introduction



This chapter starts with a revision of the treatment of partnerships. Much of the technical content in this section has been covered at TX.

A brief reminder of TX content is given and revision examples are provided to check your retention of TX knowledge.

The new ATX topic introduced is the taxation of capital gains on the disposal of partnership assets to a third party.

1 Trading income assessments for partners

A partnership is a body of persons carrying on business together with a view to profit. Despite the fact that a partnership is a single trading entity, the partnership itself is not liable to tax.

For tax purposes, all partners are:

- treated as trading in their own right, as if they were a sole trader running their own business, and
- taxed individually on their share of the partnership profits and capital gains, and
- responsible for paying their own income tax, NICs and capital gains tax arising from their share of the partnership.

The partnership is therefore taxed as a collection of sole traders operating together.

Adjusted profits and allocation between partners

A reminder of the calculation of adjusted profits for a partnership and the allocation between partners covered at TX is given below and is summarised in the diagram in section 4.



Partnership adjusted profits

The tax adjusted trading profits of a partnership are calculated in exactly the same way as for a sole trader:

- The accounting net profit is adjusted for disallowable expenditure, non-trading income, etc. in the normal way.
- Capital allowances are calculated in the normal way and deducted from the tax adjusted profits.

Note that:

- Partners' salaries and interest on capital are often charged through the statement of profit or loss. These are not allowable deductions and need to be added back, as they are an appropriation of profit and not an expense of the business.
- Capital allowances can be claimed on assets owned personally by the partners if they are used in the partnership. However, the individual partners cannot claim the capital allowances on their own behalf. The capital allowances are an allowable expense against the partnership profits as a whole.



The allocation between partners

Profits are allocated:

- according to the **profit sharing arrangements** in force
- during the **accounting period** in which the profits are earned.

Once the partners have been allocated their shares, each partner is taxed on his, her or their share of the trading profits according to the basis of assessment rules, in the same way as a sole trader.

Profit sharing arrangements (PSA) usually provide for a combination of three types of allocation:

- Salaries (a fixed allocation of profit).
- Interest on capital introduced into the business (a fixed percentage return on capital).
- Profit sharing ratio (PSR) (an agreed ratio to share the balance of profits).

The terms 'salaries' and 'interest' are just an allocation of profit, they are not assessed to income tax as employment income and savings income.

Whatever terms are used to describe the allocation method, the total amount allocated to each partner is assessed to income tax as trading income.



Test your understanding 1

Hywel and Hywyn formed a partnership in June 2016. They agreed to share profits equally after charging interest of 10% p.a. on their fixed capital accounts of £8,000 and £5,000 respectively, and paying a salary to Hywel of £5,000.

The tax adjusted trading profits for the y/e 31 December 2023 were £15,000.

Show the allocation of profits for the y/e 31 December 2023.



Change to profit sharing agreement

The profit sharing agreement between partners may change for a number of reasons:

- The existing partners may decide to allocate profits in a different way. This may be as a result of a change in duties, seniority or simply by agreement of the parties concerned.
- The membership of a partnership may change as the result of the admission, death or retirement of a partner.

Where there is a change in the PSA during the accounting period:

- The accounting period must be time apportioned into two or more parts (depending on the number of changes).
- Each part is then allocated separately between the partners according to the partnership agreement in place at that time.



Test your understanding 2

Xavier and Yvonne started in partnership on 1 January 2022 sharing profits equally, after allowing for a salary for Yvonne of £10,000 p.a. The partnership accounts are prepared to 31 December each year.

On 1 July 2023 Zack was admitted as a new partner, the profits continuing to be shared equally but with no salary allowance for Yvonne.

On 30 September 2024, Xavier retired from the partnership. Yvonne and Zack agreed to share profits in the ratio of 3:2.

The tax adjusted trading profits for the first three accounting periods are:

Year ended 31 December 2022	£50,000
Year ended 31 December 2023	£90,000
Year ended 31 December 2024	£150,000

Show the allocation of profits between the partners for the three accounting periods.

The calculation of taxable trading income for each partner

The partners are taxed on their share of the partnership profits as if they were a sole trader who runs a business that:

- starts when they join the partnership
- ceases when they leave the partnership, and
- has the same accounting periods as the partnership.

The basis of assessment rules determine in which tax year the adjusted trading profits will be taxed.



Due to the changes in the basis period rules from the current year basis to the tax year basis (see Chapter 21), the ATX examining team has confirmed the following for exams in the period 1 June 2024 to 31 March 2025:

- Unincorporated businesses will always have an accounting period ending on 5 April (or 31 March) in questions where you are required to calculate the assessable profits for a tax year.
- Some questions may involve an unincorporated business which does not have an accounting period ending on 5 April (or 31 March), but in this case the taxable trading profit for the relevant tax year(s) will be provided.
- The current year basis opening and closing year rules, together with overlap profits, will **not be tested**.
- If a question involves the commencement or cessation of an unincorporated business, the taxable trading profit for the relevant tax year(s) will be provided.

2 Partnership trading losses

The calculation and allocation of partnership trading losses

A loss in a partnership is calculated for the partnership as a whole using the same principles as calculation of a profit. Once calculated each partner is:

- allocated a share of the tax adjusted trading losses (including capital allowances)
- according to the partnership agreement in the accounting period
- in exactly the same way as profits.

Loss relief options available

Each partner is treated as a sole trader and can therefore utilise his, her or their share of the partnership loss:

- under the normal trading loss rules
- in the most tax efficient manner
- according to the partner's own personal circumstances.

The options available can be summarised as follows:

Partner joining	Ongoing partners	Partner leaving
Relief against total income	Relief against total income	Relief against total income
Relief against gains	Relief against gains	Relief against gains
Carry forward	Carry forward	
In addition:		In addition:
Opening year relief		Terminal loss relief

See Chapters 21 and 22 for a reminder of the loss relief rules.



Illustration 1 – Partnership losses

Aino, Eevi and Mary are in partnership preparing accounts to 5 April. During the tax year 2023/24 Eevi left the partnership and Maggie joined in her place.

For the year ended 5 April 2024 the partnership made a tax adjusted trading loss (after taking account of capital allowances) of £20,000.

State the loss relief claims available to each of the partners.

Solution

Eevi will be entitled to terminal loss relief since she has ceased trading.

Maggie will be entitled to claim opening years relief since she has started trading.

Aino and Mary will not be entitled to either of the above reliefs.

All the partners will be entitled to relief against total income and, if applicable, an extension of relief against chargeable gains in the current and/or previous tax years, provided a claim against total income is made first.

All the partners except Eevi will be entitled to carry forward relief.

Limited liability partnerships (LLP)

An LLP is a special type of partnership where the amount that each partner contributes towards the partnership losses, debts and liabilities is limited by agreement.

The taxation implications of an LLP are as follows:

- generally taxed in the same way as other partnerships, and
- if applicable, the normal loss reliefs are available.



3 Partnership capital gains tax

The basis of assessment to CGT on partnership gains

Each partner:

- is deemed to own a fractional share of the partnership assets, and
- is assessed separately to CGT according to that partner's own personal circumstances, if there is a disposal of some or all of the partner's fractional share in a partnership asset.

The fractional share is determined by the agreed capital profit sharing ratio in the partnership agreement.

This ratio is usually taken as:

- the PSR used to allocate the balance of profits for income tax purposes as stated in the partnership agreement
- unless the agreement says otherwise.

Each partner will:

- include the share of the partnership gains in his, her or their CGT computation, along with gains from the disposals of other assets
- if the entire partnership share is being disposed of, be able to claim business asset disposal relief if the partnership business has been owned for at least two years
- deduct the AEA of £6,000 against the total chargeable gains of the individual in the normal way
- calculate the CGT at 10% or 20%.

Capital gains tax reliefs

As partnership assets are business assets, CGT reliefs are also available in the normal way, for example:

- rollover relief
- gift holdover relief.

Note that with rollover relief and gift holdover relief, each partner can decide independently whether or not to make a claim.

If a partner decides to make a rollover relief claim:

- the partner's share of the gain is rolled over (i.e. deferred)
- against the partner's share of the cost of the replacement asset.

Disposal of a partnership asset to a third party

Strictly, each partner should have a separate capital gains computation for each partnership disposal.

A separate gain computation should be calculated allocating the sale proceeds and cost of the asset between the partners.

However, it is usually acceptable to calculate the gain arising on the asset and then allocate this one figure between the partners.



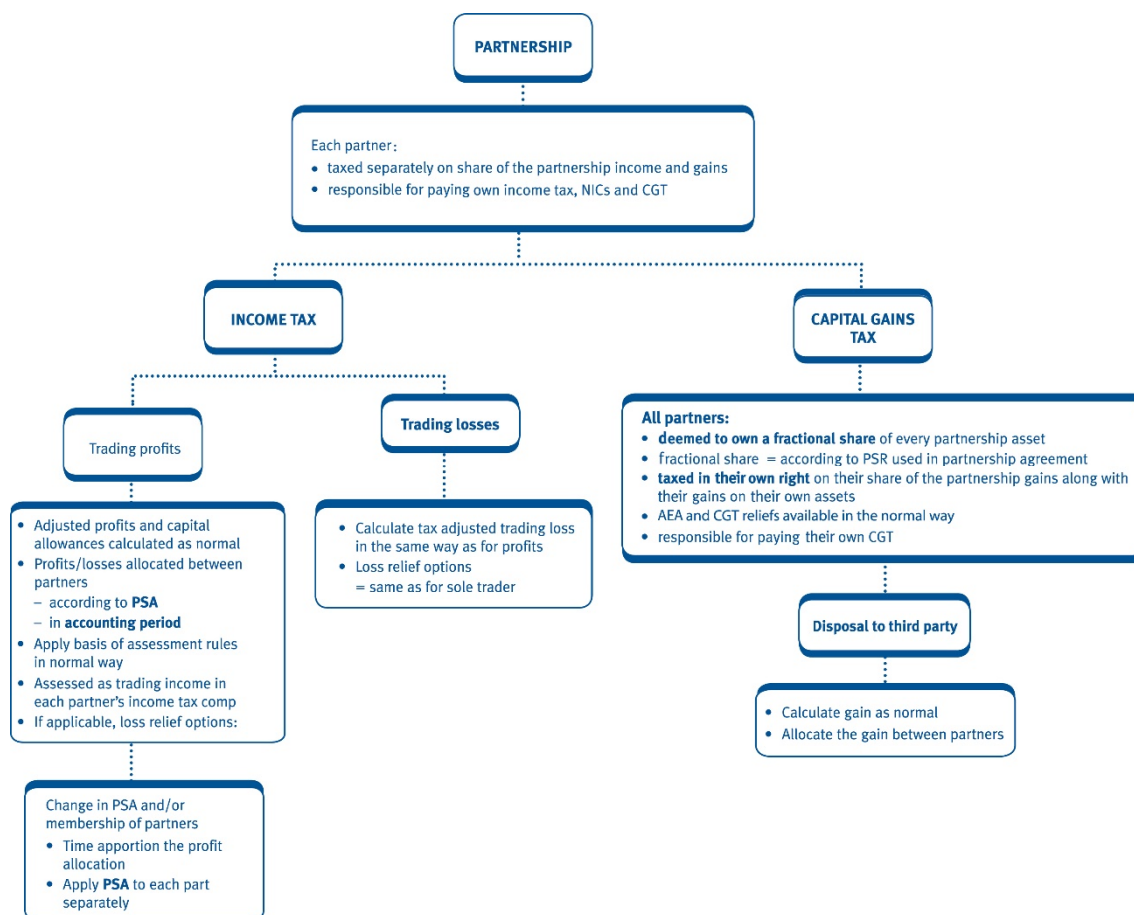
Test your understanding 3

In January 2012, Paula and Phil started in partnership. They introduced capital into the business of £30,000 and £20,000 respectively and agreed to share profits in the ratio 60%:40%.

The partnership purchased freehold premises for £125,000 in January 2012. In September 2023 the partnership sold the premises for £495,000 and continued to trade in rented premises.

Calculate the chargeable gains arising on Paula and Phil in the tax year 2023/24 in respect of the partnership disposal.

4 Chapter summary



Test your understanding answers



Test your understanding 1

Hywel and Hywyn

Y/e 31 December 2023	Total £	Hywel £	Hywyn £
Interest on capital	1,300	800	500
Salary	5,000	5,000	0
Balance shared (1:1)	8,700	4,350	4,350
	<hr/>	<hr/>	<hr/>
Allocation of profits	15,000	10,150	4,850
	<hr/>	<hr/>	<hr/>



Test your understanding 2

Xavier and Yvonne

Y/e 31 December 2022	Total £	Xavier £	Yvonne £	Zack £
Salary	10,000	0	10,000	0
Balance shared (1:1)	40,000	20,000	20,000	0
	<hr/>	<hr/>	<hr/>	<hr/>
Allocation of profits	50,000	20,000	30,000	0
	<hr/>	<hr/>	<hr/>	<hr/>
Y/e 31 December 2023				
1 January 2023 to 30 June 2023				
Salary	5,000	0	5,000	0
Balance shared (1:1)	40,000	20,000	20,000	0
	<hr/>			
	45,000			
1 July 2023 to 31 December 2023				
Balance shared (1:1:1)	45,000	15,000	15,000	15,000
	<hr/>	<hr/>	<hr/>	<hr/>
Total	90,000	35,000	40,000	15,000
	<hr/>	<hr/>	<hr/>	<hr/>

Y/e 31 December 2024	Total £	Xavier £	Yvonne £	Zack £
1 January 2024 to 30 September 2024 Balance shared (1:1:1)	112,500	37,500	37,500	37,500
1 October 2024 to 31 December 2024 Balance shared (3:2)	37,500	0	22,500	15,000
Total	150,000	37,500	60,000	52,500



Test your understanding 3

Paula and Phil

	Paula £	Phil £	Total £
Sale proceeds (60%:40%)	297,000	198,000	495,000
Less: Cost (60%:40%)	(75,000)	(50,000)	(125,000)
Chargeable gain	222,000	148,000	370,000

The partnership asset is not part of the disposal of the entire business, so business asset disposal relief is not available.

Note: To save time in the examination, it is acceptable to compute the total gain of £370,000 and allocate it 60%:40% to the partners.

However, it is an important principle to appreciate that each partner technically owns a fractional share and that each partner should do his, her or their own capital gains computation.

Family companies and related planning scenarios

Chapter learning objectives

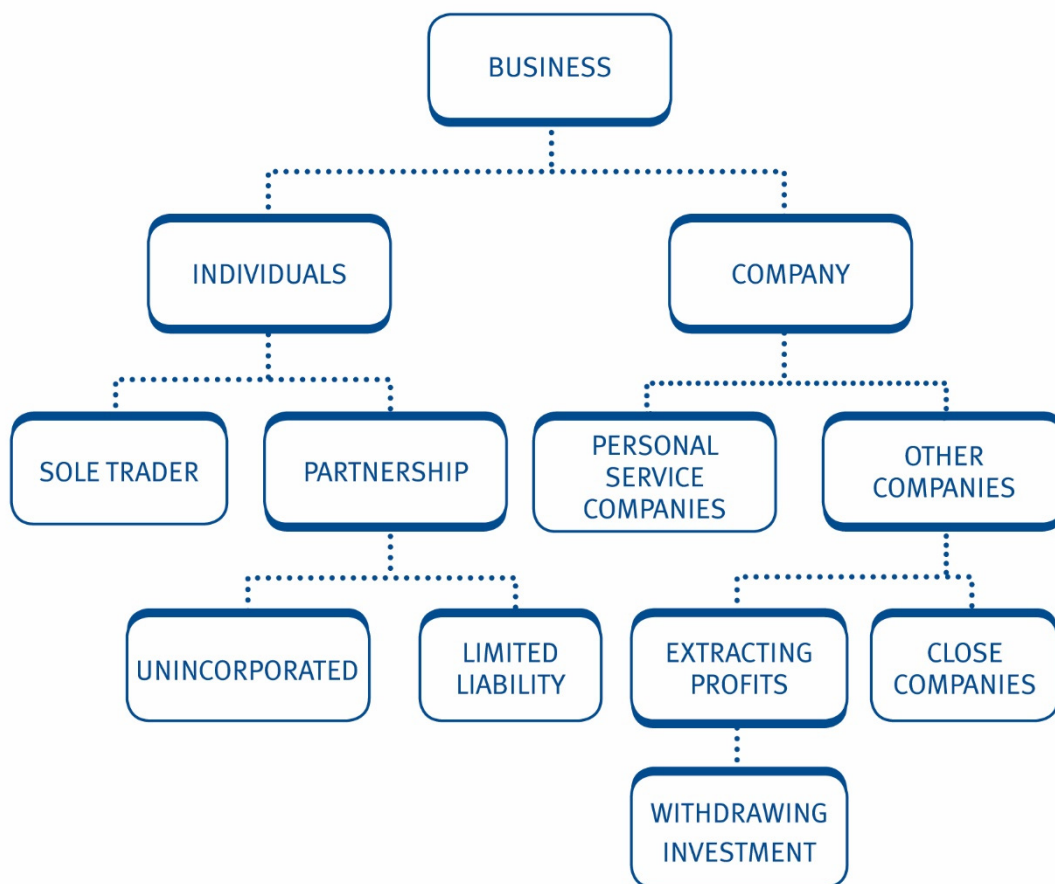
Upon completion of this chapter you will be able to:

- identify personal service companies and advise on the tax consequences of services being provided via a personal service company
- apply the definition of a close company to given situations
- conclude on the tax implications of a company being a close company or a close investment holding company
- conclude on the tax treatment of returns to shareholders after winding up has commenced
- advise on the tax implications of a purchase by a company of its own shares
- identify and advise on the taxes applicable to a given course of action and their impact
- assess the tax advantages and disadvantages of alternative courses of action
- understand the statutory obligations imposed in a given situation, including any time limits for action and advising on the implications of non-compliance
- identify and advise on the types of investment and other expenditure that will result in a reduction in tax liabilities for an individual and/or a business

- advise on legitimate tax planning measures, by which the tax liabilities arising from a particular situation or course of action can be mitigated
- advise on the appropriateness of such investment, expenditure or measures given a particular taxpayer's circumstances or stated objectives
- advise on the mitigation of tax in the manner recommended by reference to numerical analysis and/or reasoned argument
- be aware of the ethical and professional issues arising from the giving of tax planning advice



One of the PER performance objectives (PO17) is to assess the tax implications of proposed activities or plans, referring to up to date legislation. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter considers multi-tax scenarios from a business perspective and introduces tax planning measures to minimise tax liabilities.

Much of the content of this chapter is covered in more detail in other chapters. However, this chapter aims to show how various ideas and taxes interact and form the basis of multi-tax scenario examination questions.



Areas covered in this chapter which primarily draw from previous knowledge from your TX studies include:

- Choosing the appropriate business vehicle when starting to trade.
- Extracting profits from a company.

The new areas at ATX introduced in this chapter include:

- Close companies.
- Personal service companies.
- Exit strategies such as the purchase of own shares by a company and putting a company into liquidation.

1 Business vehicle

When an individual decides to start a business, one of the most important factors to consider is how to own it.

Direct ownership will be as a sole trader, or if there is more than one person involved, a partnership.

The alternative is to set up a limited company, and own the assets through the company. The individuals involved will then be shareholders and (probably) directors of the company.



Each method has its own tax implications.

The main areas that need to be considered are:

- What amounts does the individual pay tax on?
- Is there a liability to NIC?
- When is any tax payable?
- Commercial considerations.

Summary of differences



The main differences between operating as an unincorporated business or as a company can broadly be summarised as follows:

	Sole trader	Company
Taxation of profits	<p>Trading profit taxed under income tax rules.</p> <p>Adjustments for private use when calculating trading profit.</p> <p>Capital allowances with private use adjustments.</p> <p>Personal allowance.</p> <p>Income tax at: 20%/40%/45%.</p> <p>Class 4 NICs = 9% of profits (£12,570 to £50,270) and 2% thereafter.</p> <p>Class 2 NICs = £3.45 per week.</p>	<p>Corporation tax on TTP – after the individual has paid themselves a salary.</p> <p>No adjustments for private use when calculating trading profit – instead the individual is taxed on benefits received.</p> <p>Capital allowances in full (no private use adjustments).</p> <p>No personal allowance for the company (although the individual will have a personal allowance to set against the income extracted).</p> <p>Corporation tax at: 19% (small profits rate) 25% (main rate).</p>

Relief for losses	<p>Relief available against total income of individual.</p> <p>Opening years relief – loss in any of first four tax years, set against total income of three preceding tax years (FIFO).</p> <p>Relief against total income of current/previous tax year.</p> <p>Extension against chargeable gains in same years.</p> <p>Carry forward against trading profit of same trade.</p>	<p>Loss relieved against company's total profits (income and gains) only.</p> <p>No opening years relief available.</p> <p>Current year – set against total profits (income and gains) of current AP.</p> <p>Prior year – set against total profits (income and gains) of previous 12 months.</p> <p>Carry forward – against future total profits (income and gains).</p>
Withdrawal of funds	<p>No tax implications – all profits already taxed on the individual as trading profit.</p>	<p>Salary/Bonus</p> <ul style="list-style-type: none"> • Employment income for individual. • Allowable deduction for the company. • Employee class 1 NICs. • Employer's class 1 NICs for company (allowable deduction). <p>Dividend</p> <ul style="list-style-type: none"> • Taxed on a cash receipts basis. • Taxed as top slice of income. • First £1,000 covered by the dividend nil rate band. • Excess taxed at 8.75%/33.75%/39.35%. • Dividends not an allowable deduction from trading profit for a company. • Company must have distributable profit.

VAT	Individual registers	Company registers
Disposal of business	<ul style="list-style-type: none"> Gains on individual chargeable assets: Gains are business assets: <ul style="list-style-type: none"> for gift holdover relief for business asset disposal relief if disposal of the entire business. <p>IHT – 100% BPR on gift/legacy.</p>	<p>Gain on shares:</p> <ul style="list-style-type: none"> Shares in an unquoted trading company will usually be business assets. Gift holdover relief if shares gifted. Business asset disposal relief or investors' relief on disposal. <p>IHT – 100% BPR on gift/legacy.</p>

Considerations when choosing the relevant structure



Intention to withdraw **profits**:

- A sole trader is required to pay tax on the profits made, not the amount drawn out of the business.
- Where it is not intended to withdraw all the profits, it will probably be more advantageous to operate as a company, as the company pays tax at 19% or 25% allowing the retained profits to be taxed at the lower rate (although the future extraction of funds will potentially have further tax consequences).

Initial losses

- If the business will start with losses it may be preferable to structure it initially as a sole trade, allowing the losses to be used against the owner's total income and take advantage of opening years loss relief, which is only available to individuals, not companies.
- Once the business becomes profitable, it may be incorporated if a company is the preferred structure.

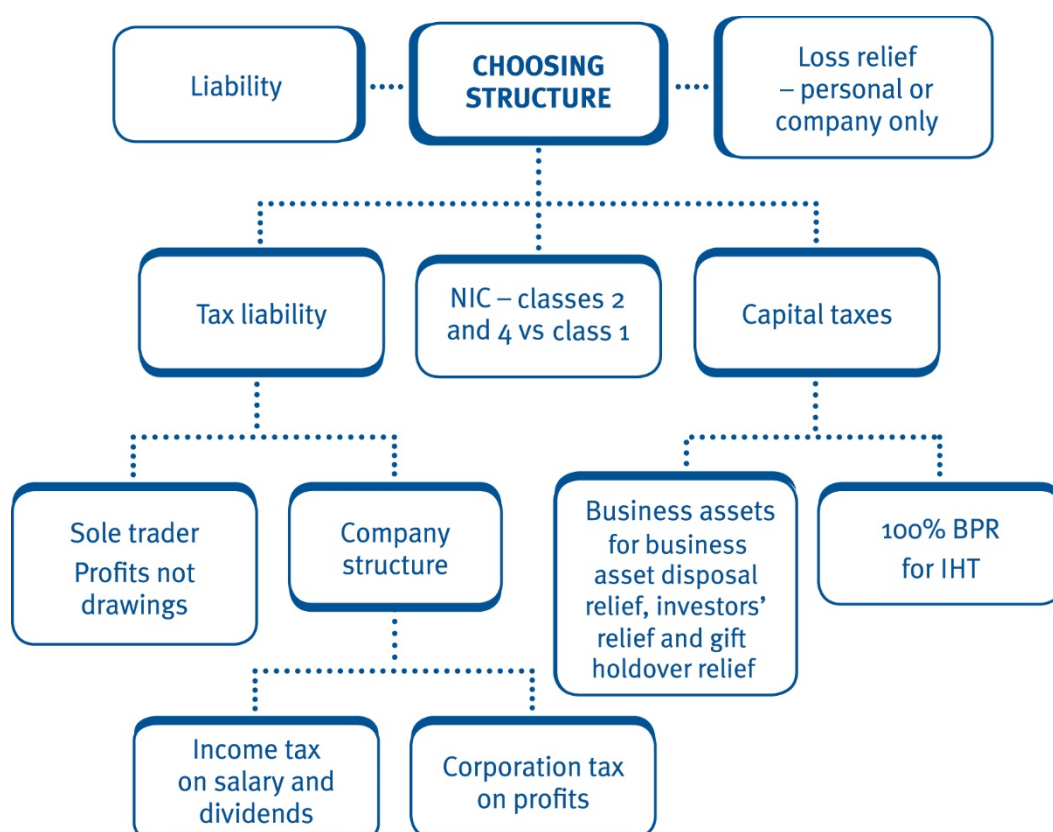
Liability

- Where liability is an issue, a company will probably be preferred as a corporate structure will limit the individual's potential liability.
- However, it should be remembered that some businesses are not allowed to incorporate. In this case a Limited Liability Partnership (LLP) may be used.

Limited liability partnership

- An LLP is taxed in the same way as an unincorporated partnership, with each partner paying tax on a share of the profits.
- Each partner's liability is limited to the amount that partner invested in the LLP. However, there is no limit to the liability for work that the partner is personally responsible for.

Summary



2 Close companies

Definition of a close company

Many 'owner managed' businesses will be close companies.



A close company is a company controlled by:

- any number of directors, or
- five or fewer participators.

'Control' means holding > 50% of:

- the issued share capital of the company, or
- the voting power, or
- the right to receive distributable profits, or
- the right to receive the net assets in the event of a winding up.

A participator is primarily a shareholder.

To decide whether a group of individuals has control of the company it is necessary to include the shares of their associates.

Associates are taken to be the spouse or civil partner, children and issue, parents and remoter ancestors, brothers and sisters and business partners.

A company which is a subsidiary takes its status from the parent company.

So, if the parent company of a group is a close company, the subsidiary is also a close company.

If the parent company is not a close company, the subsidiary will not be close either, even if it is a wholly-owned subsidiary.



Test your understanding 1

Shares in La Famille Ltd are owned as follows:

	% shares
Jeanette	12
Arthur (Jeanette's husband)	6
Louis (Jeanette's son)	5
Cecile (Jeanette's cousin)	5
Hugo (unconnected) (the only director)	20
Felicity (unconnected)	4
24 other unconnected shareholders, each with 2%	48
	<hr/>
	100
	<hr/>

Explain whether or not La Famille Ltd is a close company.



An examination question may require you to identify that a company is close. Therefore you need to be able to spot a close company scenario, even if you are not told there is one!



Implications of close company status

In close companies, shareholders (who may also be directors) may have significant influence over company resources and decisions. There are anti-avoidance measures in place to prevent these shareholders benefiting unfairly from their significant influence over a close company.

The principal measures cover:

- the provision of benefits to shareholders, and
- the provision of loans to or from shareholders.

In considering the measures, the status of the individual must be identified:

- the individual may be a shareholder only, or
- the individual may be both a shareholder and an employee/director.

The provision of benefits to shareholders

The provision of a benefit to an individual who is an employee/director is subject to the employment income provisions.

- For the company, the cost of providing the benefit is an allowable expense and reduces trading profits.
- For the individual, the taxable benefit is calculated using employment income rules.



The tax implications for the company and the individual shareholder of the provision of a benefit to a shareholder (or the shareholder's associate) who is not an employee/director are as follows:

Company	Individual (shareholder)
The company is deemed to have paid a dividend. There is no need for the company to have sufficient distributable profits as the provision of the benefit is not a genuine dividend.	No employment income charge possible as no office or employment.
The amount (i.e. value) of the dividend is determined using the benefit rules.	The value of the benefit is treated as a dividend.
No trading profit deduction for the cost of providing the benefit as it is treated as a dividend.	<p>This will be taxed in the year the benefit is provided.</p> <p>The first £1,000 of dividend income is covered by the nil rate band and the excess is taxed at the rate of 8.75% if the individual is a basic rate taxpayer, 33.75% if higher rate, or 39.35% if additional rate.</p>



Test your understanding 2

Abdullah and Habiba are shareholders of Houghton Ltd, a close company. Abdullah is also a director of the company.

Houghton Ltd provided each of them during the current accounting period with a new petrol engine company car, list price £20,000 and a CO₂ emission rate of 101g/km. They each travel 5,000 miles; 3,000 miles of Abdullah's mileage is on company business. The company does not pay for private petrol for either Abdullah or Habiba.

Houghton Ltd is a profitable company paying corporation tax at 25%.

Abdullah and Habiba are both higher rate taxpayers.

Explain the tax implications for the company and the individuals of the provision of the company cars.

The provision of a loan to a shareholder



The provision of a loan to a shareholder, irrespective of employment status, has the following implications:

For the company

- There is a tax charge of 33.75% of the amount of the loan.
- 'Loan' includes amounts owed to the company by the participator (including overdrawn directors' accounts) and also debts of the participator that have been assigned to the company.
- This charge is paid at the same time as the corporation tax liability (i.e. either nine months and one day after the end of the accounting period or the charge is built into the company's quarterly instalment payments).
- No tax is payable if the loan has been repaid before nine months and one day after the end of the accounting period.
- Where the tax charge has been paid, it becomes repayable when:
 - (1) the loan is repaid:
 - where part of the loan is repaid the same proportion of the tax is repayable
 - (2) the loan is written off:
 - the company can reclaim the tax paid when the loan was made
 - there is no deduction for the write-off against the company's profits for CT purposes
 - at this point the individual becomes liable for income tax and possibly NICs (see below)
 - if the individual is an employee then class 1 employer's NICs will be payable which will be an allowable deduction against the company's profits for CT purposes.

- As the tax charge will eventually get repaid to the company, it is merely a cash flow issue for the company.
- No tax is payable by the company where the loan fulfils three requirements:
 - (1) The amount of the loan is less than or equal to £15,000, and
 - (2) The individual is a full-time working employee, and
 - (3) The individual (including associates' interests) owns 5% of the shares or less.

For the shareholder

- There are no immediate tax implications for the individual when the company makes the loan.
- If the loan is written off, the individual will then become subject to income tax on the amount written off as though it was a dividend received at the date of the write-off. Class 1 employee NICs will also be due on the write off in the shareholder is also an employee.

Interest

Where the company does not charge interest of at least the official rate (currently 2.25%), there will be a taxable benefit. The rules for the provision of benefits apply (see above).

- For an employee, this benefit will be taxed as earnings.
- Where the individual is not an employee, the benefit will be treated as a dividend distribution.



Test your understanding 3

Sally and Claire are both shareholders and full time employees in White Ltd, a close company. The company prepares its accounts to 31 March annually and is not a large company for quarterly instalment purposes.

Sally owns 15% of the company, whilst Claire owns 3%. They are not connected with each other. The company lends each of them £12,000, on 6 April 2023. Claire repays £4,000 on 31 December 2023. Interest of 1.5% is charged on the loans.

Explain the tax implications for both White Ltd and its employees Sally and Claire of the loans made by the company.

Ignore national insurance contributions.

The provision of loans from shareholders to the close company

A shareholder may take out a personal loan in order to make a loan to or buy shares in a close company.

Income tax relief on interest paid on such borrowing is available as a relief deducted from total income, provided the company is not a close investment company (see below).



The conditions are that the individual:

- has a material interest (more than 5%) in the company, or
- is a full-time working officer or employee involved in the management of the company.

The maximum deduction allowed from total income includes this type of qualifying interest (Chapter 16).

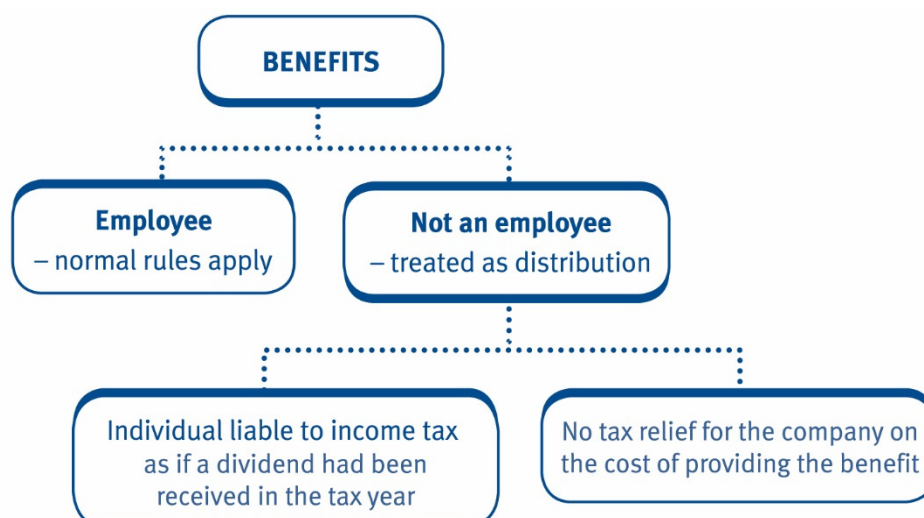
Close investment holding company (CIC)

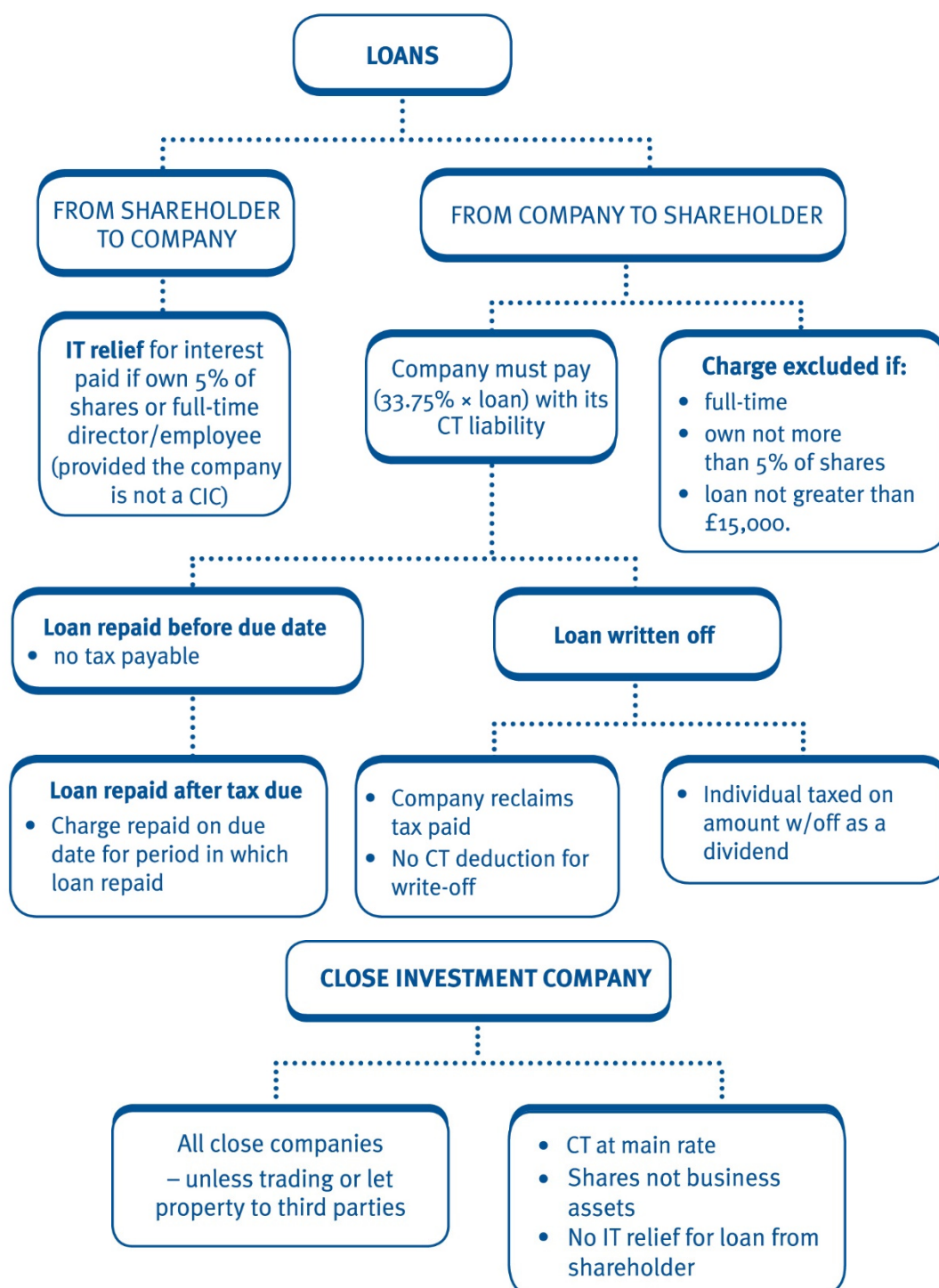
All close companies are close investment companies (CIC) unless their main activity is trading, or letting property to unconnected persons.

The tax consequences of a CIC are as follows:

- CICs are required to pay corporation tax at the main rate (i.e. 25%), irrespective of the level of their profits
- The shares will not be treated as business assets for IHT nor CGT.
- Tax relief will not be available to an individual for money borrowed to invest in a CIC.

Summary





3 Extracting profits from a company

Many UK companies are small trading companies, and consideration is often given to tax efficient means of extracting profits in either an income or capital form.

This section considers the methods of extracting profits from a company and the implications for both the company and the individual shareholder and/or director.



Salary v dividend

	Salary	Dividend
Rates of IT	20%/40%/45%	0%/8.75%/33.75%/39.35%
NICs paid by individual	Individual must pay class 1 NICs on the salary at 12%/2%.	No NICs payable on dividends.
NICs paid by Company	Employer must pay class 1 NICs on the salary at 13.8%. Note that the £5,000 NIC employment allowance is not available where the director is the sole employee earning over £9,100.	No NICs payable on dividends.
CT implications for company	The salary paid to the employee and the NICs paid by the company are treated as staff costs. This reduces the trading profit of the company and the CT payable.	None.
Pension contributions	Salary is earned income and is relevant earnings for pension tax relief purposes.	Dividends are not earned income and are not relevant earnings for pension tax relief purposes.
Formalities	If a bonus is accrued at the end of the accounting period, it must: <ul style="list-style-type: none"> • be paid within nine months of the end of the accounting period, and • comply with IAS 37. 	The company must have distributable profits to be able to pay a dividend.



Test your understanding 4

Norman is the only shareholder and employee/director of Fletcher Ltd. He has been paid a salary of £52,000.

It has been decided that there are £50,000 of profits before corporation tax that can be used to either pay a bonus to Norman, or a dividend. The £50,000 is to include any employer's NIC liability.

Fletcher Ltd pays corporation tax at 25% on its profits.

Calculate the amount Norman will receive after all taxes have been paid and the overall tax cost of the additional profit extraction.

Other possibilities

There are a number of other possible ways of extracting profits, depending on the individual situation which include:

- charging rent
- charging interest, and
- funding a pension scheme.

Further details of these extraction methods are given below.



Rent

- Where property is to be bought for the use of the company it may be preferable to consider owning it personally and charging the company rent for its use.
- The rent would be an allowable deduction for corporation tax, providing it was at no more than a commercial rent.
- When the individual retires, the property may be sold with the shares or could be retained so that the rent received would supplement the individual's pension income.
- A further advantage of direct ownership is that if the company owns the asset there will be two charges to tax before the individual receives the proceeds of a sale of the property:
 - (1) The company pays corporation tax on any gain arising.
 - (2) The individual would then be taxable when the profits were extracted from the company.
- A slight drawback of holding the property outside the company is that if IHT became an issue, BPR would only be available at 50%. However, if the business is sold before the individual dies this would not create a problem. If there was a concern about a charge, insurance could be taken to cover any liability that may arise on death.
- Further, on the disposal of the property it would not qualify for business asset disposal relief even if sold at the same time as the disposal of the company shares. This is because the associated disposal rules do not apply where a market rent is charged to the company by the individual for the use of the asset (see Chapter 9).



Interest

- Where the individual has lent money to the company, interest may be paid by the company to the individual. The rate applied cannot be in excess of a commercial rate.
- There may be a timing advantage as the company will deduct the interest on an accruals basis but the individual is not taxed until it is received:
 - Consider a company with a year ended 31 March 2024. Interest can be accrued within the accounts for that period but providing it is not paid until 6 April 2024 it will only be taxed on the individual in the tax year 2024/25.
- The individual will be taxed on the interest received in excess of the savings income nil rate band at 20%/40%/45% depending on whether the individual is a basic/higher/additional rate taxpayer. The savings income nil rate band is £1,000/£500/£Nil depending on the level of taxable income.
- Where the individual and the company are connected, the interest must be paid within 12 months of the end of the accounting period to be allowable as a deduction for the period in which it is accrued. If it is not, it only becomes an allowable deduction for corporation tax when it is paid.



Pension contributions

- The company may make contributions to a pension scheme on behalf of the individual. Providing they fall within the approved limits there would be no income tax or NIC liability.
- The main drawback of this method of extraction is that the pension funds cannot be accessed until the individual is at least 55.

Summary

Type of payment	Liable to IT?	NIC	Pensionable income	CT deductible?
Salary	Yes	Class 1	Yes	Yes – providing paid within nine months of end of the AP and complies with IAS 37
Dividend	Yes	No	No	No
Rent	Yes	No	No	Yes – providing at commercial rate
Interest	Yes	No	No	Yes – providing not at > commercial rate and paid < 12 months of end of AP
Pension contributions	No	No	No	Yes when paid



4 Personal service companies (PSC)



The purpose of the PSC legislation

The purpose of the legislation on personal service companies (PSC) is to counter practices of tax avoidance which were becoming widespread.

Reference is sometimes made to these rules as 'off payroll working' or the IR35 legislation, which is the name of the original HMRC press release issued that set out the objectives of the legislation.

The schemes that the legislation aims to combat are as follows:

- Many businesses have been reluctant to pay individuals for their services directly as self-employed individuals because if HMRC reclassify them as employees there can be substantial costs and penalties incurred by both the self-employed business and the business employing their services (the client).
- As a result:
 - individuals who were self-employed have been encouraged to set up companies which the client would then contract with, and pay the company for the individual's services. Where the client is paying a company it would be more difficult to argue that the individual was a direct employee of that client.
 - companies have encouraged existing employees to resign, set up a company, and the client would then use their services through that company, resulting in a major saving of NICs for that client.

- The company owned by the individual worker is referred to as a Personal Service Company (PSC).



Advantages to the individuals

Individuals realised that operating through a company could have advantages as follows:

- (1) The PSC invoices for the individual's services (plus VAT, if appropriate) and
 - the client pays the invoices gross without having to apply the PAYE regulations
 - there are no employer's NICs payable.
- (2) The PSC pays CT at only 19% or 25% on profits net of any expenses wholly and exclusively incurred for the trade.
- (3) The individual is an employee of the PSC, or better still, a director without a contract of employment thereby side-stepping the National Minimum Wage regulations.
- (4) The individual could draw sufficient remuneration (or director's fees)
 - to exceed the lower earnings limit for NIC purposes thereby creating entitlement to benefits
 - but below the primary threshold so that no class 1 liabilities arise.

The individual can then draw out the rest of the profits of the business as dividends.

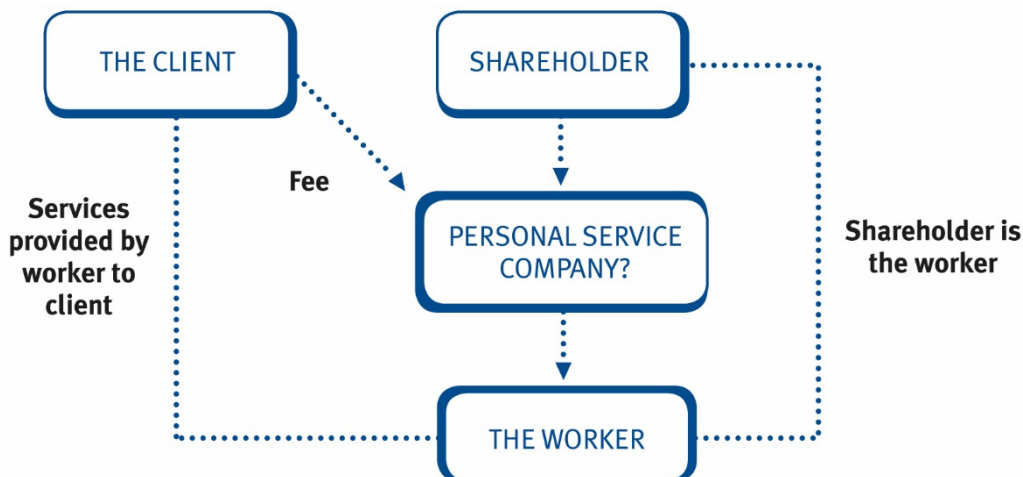
- (5) There is scope for dividing the shareholding of the PSC with a spouse or civil partner so that two basic rate bands are utilised before higher rate income tax is payable.
- (6) Income could be rolled up indefinitely net of a 19% or 25% CT charge so that good and bad years can be evened out and the individual need never pay higher rate tax unless the individual so chooses.

As a result of such schemes HMRC introduced rules to combat what they perceived was a loss of tax/NIC arising where individuals used a company to bill their services to a client.

What makes a company a PSC?



HMRC look at the relationship between the client and the worker.



HMRC will ask the question: if the company was not there, would the worker be an employee of the client or self-employed? The normal rules for deciding employment or self-employment are used (see Chapter 17).

If the situation is considered to be one of employment the company owned by the worker is a PSC, and the special legislation applies.

There are different rules depending on whether the client is small or not, and both sets of rules are covered separately below.

It is the responsibility of all medium or large private sector clients (and all public authority clients) to determine whether the worker is deemed to be an employee, and therefore if the PSC is caught by the legislation.

By contrast, it is the responsibility of the PSC to determine this and apply the rules if the services are provided to a small client.



For PSC purposes, the question in the examination will state the size of the client organisation.

Both sets of rules only apply if the individual has an interest of at least 5% in the company or an entitlement to receive payments from the company, other than salary, in respect of the services provided to the client.

Services provided via a PSC to a small organisation

For services provided to a small client, only 'relevant engagements' will be caught by the rules. These are contracts between the company and the client which would have been a contract of employment in the absence of the PSC. It is the responsibility of the PSC to determine whether any of its engagements are 'relevant engagements'.

Although the client of the PSC is a significant beneficiary of the abuse, they are not the focus of the provisions.

The PSC has to:

- treat the income from relevant engagements arising in a tax year **as if it were paid out as salary** to the employee, and
- account for the notional income tax and NICs on 19 April following the end of the tax year.

This **notional** salary is deemed paid at the end of the tax year.



Notional salary

The notional salary is the income from the relevant engagements, reduced by the following:

- any actual salary and benefits received in the year
- expenses incurred by the company which would have been deductible under the employment income rules if the individual had incurred them personally
- contributions made by the company to an occupational pension scheme
- employer's NICs paid during the year on actual salary and on the notional salary
- 5% of gross payments from relevant engagements as a flat rate deduction to cover such things as overheads and training (it is not possible to deduct actual expenses instead), whether or not the money is spent.

Pro forma for notional salary calculation

	£
Amount received in tax year from relevant engagements	X_A
Less: Statutory deduction ($5\% \times X_A$)	(X)
Employer's NICs paid by PSC	(X)
Pension contributions by PSC	(X)
Salary paid by PSC	(X)
Allowable expenses	(X)
	<hr/>
Deemed salary including PSC's deemed employer's NICs	X_B
Less: PSC's employer's NICs [$X_B \times (13.8/113.8)$]	(X)
	<hr/>
Notional salary	X
	<hr/>

The £5,000 employment allowance (if available) cannot be used to offset any employer's NICs arising on the notional salary.

To avoid a double charge to tax:

- The notional salary and NICs are allowable for calculating corporation tax profits.
- Where dividends are subsequently paid out of this income they are ignored as part of the individual's taxable income.



Test your understanding 5

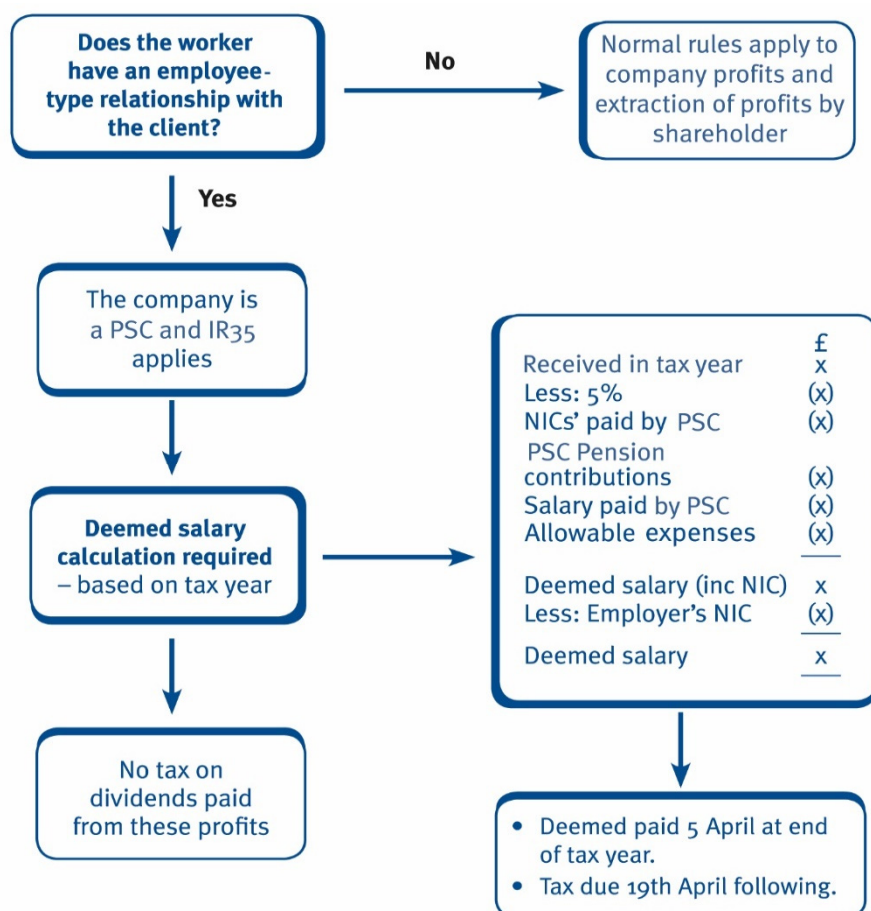
Brianna is a consultant trading through a personal service company, Conrad Ltd. She is the only director/employee and owns all of the shares of the company.

During the tax year 2023/24 Brianna was occupied almost full-time under a contract Conrad Ltd had with Wilson Ltd, a small organisation. Wilson Ltd paid Conrad Ltd £70,000 in fees for Brianna's services. Conrad Ltd did not receive any other income.

Brianna drew a salary of £25,000 from Conrad Ltd in the tax year 2023/24 which is taxed via PAYE and employer's NICs of £2,194 were paid.

- Calculate the deemed employment income arising from the relevant engagement with Wilson Ltd and the income tax and the employer's NICs payable in respect of the relevant engagement.**
- Calculate the corporation tax payable by Conrad Ltd in the year ending 31 March 2024, assuming the personal service company legislation applies.**

Summary for services provided via PSC to small organisation



Services provided via a PSC to a medium or large organisation

Where a medium or large client organisation engages with a PSC it is the responsibility of the client to determine the status of the individual worker. The client will issue a Status Determination Statement to the individual which sets out their determination.

If the client determines that the PSC rules should apply then it is required to calculate and pay the income tax and NICs on the deemed direct payment (DDP). The DDP is calculated as set out below:

	£
Payment in respect of services provided (net of VAT)	X
Less: Direct cost of materials incurred by the PSC	(X)
Less: Deductible employee expenses incurred by the PSC	(X)
	—
Deemed direct payment (DDP)	X
	—

In order to avoid double taxation, the DDP is deducted from any payment made by the PSC to the worker (such as salary) before calculating the income tax and NICs on that payment.



Test your understanding 6

Gok provides interior design services through a personal service company, Wan Ltd. Wan Ltd has a contract with Bless plc to provide Gok's design services. Bless plc is classed as a medium or large size client organisation and has issued a Status Determination Statement to Gok stating that his services fall within the PSC rules.

Wan Ltd has sent Bless plc an invoice for £20,000 (VAT-exclusive) for Gok's design work for the year ended 5 April 2024.

Wan Ltd incurred expenditure of £500 in respect of stationery used in the provision of the design services.

Calculate the deemed direct payment arising from the relevant engagement with Bless plc.

5 Withdrawing investment from a company

Overview



When a shareholder wishes to withdraw his, her or their investment from a company there are a number of exit strategies available.

- The shareholder could sell the shares in the company.
- The company could purchase the shares back from the shareholder.
- The company could be put into liquidation.

Sale of shares

The simplest method of withdrawing investment in a company is to sell the shares:

- This may not be as easy as it sounds as there is no ready market for shares in unquoted companies. They can usually only be sold to the other shareholders, or with their permission to a third party.
- If the shares are sold the main tax to consider will be CGT, and the availability of business asset disposal relief (BADR).

Most shares in unquoted trading companies will be qualifying assets if the individual has been a full-time employee or director of the company. Therefore, if the shares have been owned for at least two years, BADR would apply.

Note that investors' relief may be available on the disposal of shares

- but the shares must be held for three years post 6 April 2016, and
- the shareholder cannot be an employee.
- Before the shares are sold it may be possible to pay a dividend (assuming the company has distributable profits). This would reduce the value of the shares on sale.

To decide if this is worthwhile it will be necessary to consider the tax rates that apply to the amounts received by the shareholder.

- Dividends are taxed at 0% on the first £1,000 and then 8.75%/33.75%/39.35% depending on whether the shareholder is a basic/higher/additional rate taxpayer.
- Where BADR or investors' relief is relevant (ignoring the AEA) CGT will be payable at 10% on the first £1 million (£10 million for investors' relief) of gains for a taxpayer. After the relevant threshold has been exceeded any remaining gains are taxed at an effective rate of 10% or 20%.

Therefore, a BR taxpayer may benefit from a dividend being paid before the shares are sold, but a higher or additional rate taxpayer with dividends in excess of £1,000 would not.



Purchase of own shares



Where it is not possible to sell the shares to another person, it may be possible for them to be bought by the company.

Depending on how the transaction is structured the amount received for the shares will be treated as:

- an income distribution (dividend), or
- a capital payment.

The income distribution will trigger a tax liability for an individual who has dividends in excess of £1,000. Assuming BADR is available it may be better structured as a capital disposal, where the rate of capital gains tax is 10%.

Conditions for treatment as a CGT disposal

- (1) The company must be an unquoted trading company (companies quoted on the AIM are treated as unquoted).
- (2) The shareholder must be resident in the UK.
- (3) The shares must normally have been owned by the shareholder for at least five years (three years if inherited, including the ownership of the deceased person). If acquired from the spouse or civil partner, the combined length of ownership is considered.

- (4) The shareholder must either dispose of his, her or their entire interest in the company or the interest must be substantially reduced. This means the shareholder's percentage shareholding after the repurchase does not exceed 75% of the shareholder's previous percentage holding.
- (5) The shareholder must not immediately after the purchase be connected with the company (i.e. be able to control it or be in possession of >30% of the voting power).
- (6) The purchase must be for the benefit of the trade and not part of a scheme to avoid tax, for example:
 - buying out retiring directors
 - buying out dissident (disruptive) shareholders
 - a shareholder has died and the beneficiaries do not want the shares
 - a venture capitalist withdrawing investment.

If any of the above provisions do not apply the payment will be treated as a distribution.

Companies may seek HMRC clearance to ensure that the capital treatment applies.

Note that the taxpayer cannot choose which treatment is to apply. If the specified conditions are fulfilled it must be treated as a capital disposal, and if not it will be an income distribution.

Tax treatment

If treated as a capital disposal, a normal CGT computation applies.

If treated as an income distribution, the amount of the distribution is the excess of the payment over the amount originally subscribed for the shares. If the member in question was not the first shareholder of those shares a capital loss will arise here, calculated as the difference between the subscription price and the cost of the shares to them.

Where the person whose shares are being purchased is a company HMRC will always treat the event as a capital disposal.

Note that any legal costs and other expenditure incurred by the company in purchasing its own shares will not be allowable against the company's profits for corporation tax.



Test your understanding 7

You act as tax advisor for Bliss Ltd (which operates a successful events business) and its managing director, Davi.

The company has made tax-adjusted trading profits in excess of £250,000 p.a. over the previous five years. It has now built up a substantial reserve of cash, since its policy has been not to pay out any dividends. The company has not made any chargeable gains in recent years and has always prepared accounts to 30 April.

Davi informs you that he and Hamza, his fellow shareholder, are in serious disagreement about the future strategy of the company and that this is having a very harmful effect on the running of the business.

It has therefore been decided that Hamza should no longer be involved in the management of the company and that the company will purchase all of his shares from him.

Further relevant information

- (1) Hamza has worked in the company as a full-time director since it was incorporated on 1 June 2010, when he acquired 10% of the ordinary shares for £3,000.
- (2) Hamza has taxable employment income of £50,000 per annum after deducting his personal allowance. He received no other income in the tax year.
- (3) The company has agreed to buy back Hamza's shares at market value of £600,000 on 1 April 2024.
- (4) All of Bliss Ltd's assets are in use for the purposes of the trade.

Set out the tax implications for Hamza if the:

- (a) **income treatment applies.**
- (b) **capital treatment applies.**



Liquidation

Many people associate liquidation with a company that has gone bankrupt. This is not always the case. A liquidation can be an effective way of extracting the final value from the company where:

- the net assets of the company are worth more than the shares on a going concern basis, or
- no one wishes to buy the shares in the company as it stands.

The process of liquidation is normally as follows:

- (1) The liquidator is appointed, and the trade ceases.
- (2) The assets of the company are sold, the outstanding debts collected, and the liabilities paid.

- (3) There will be corporation tax due on any profits and gains made on the disposal of the assets, and this must be paid.
- (4) The liquidator pays out the balance of the funds to the shareholders, and the shares are cancelled.
- (5) The shareholders pay any tax due on the amounts received.

If payments are made to the shareholders:

- **before the liquidator is appointed** they are taxed as **dividends**
- **after the liquidator is appointed** they are treated as **capital receipts** for the disposal of the shares.

Whichever of these two the taxpayer prefers will, again, depend on the taxpayer's relevant income tax rates, and CGT position.



Test your understanding 8

Simon set up an unquoted trading company on 1 July 2015, and acquired 100% of the shares for £1,000. He has always worked as a director of the company.

The business has been successful but he has decided that now is the time to retire.

A liquidator will be appointed on 1 January 2024, to oversee the disposal of the assets and the winding-up of the company.

It is anticipated that after the assets have been sold the statement of financial position will be as follows:

	£
Bank and cash	840,000
Liabilities (incl. corporation tax due on profit)	(120,000)
	<hr/>
	720,000
	<hr/>
Share capital	1,000
Retained profits	719,000
	<hr/>
	720,000
	<hr/>

Simon is an additional rate taxpayer. He has not received any dividends in the tax year 2023/24 but has realised substantial gains already in that tax year.

Calculate the impact of extracting the profits as follows:

- (i) **£180,000 before the liquidation commences, with the remaining £540,000 paid on 1 April 2024.**
- (ii) **The whole £720,000 is paid out on 1 April 2024.**

Winding-up

The costs of appointing and paying a liquidator can be high.

Where the business is profitable it is possible to wind-up the company without the formal appointment of a liquidator.

HMRC will allow payments made to shareholders to be treated as capital, even though no liquidator has been appointed, providing:

- the company is being wound-up, and
- all liabilities are agreed and subsequently paid (including the individual's personal liability on any distribution by the company)
- the total payment is no more than £25,000.

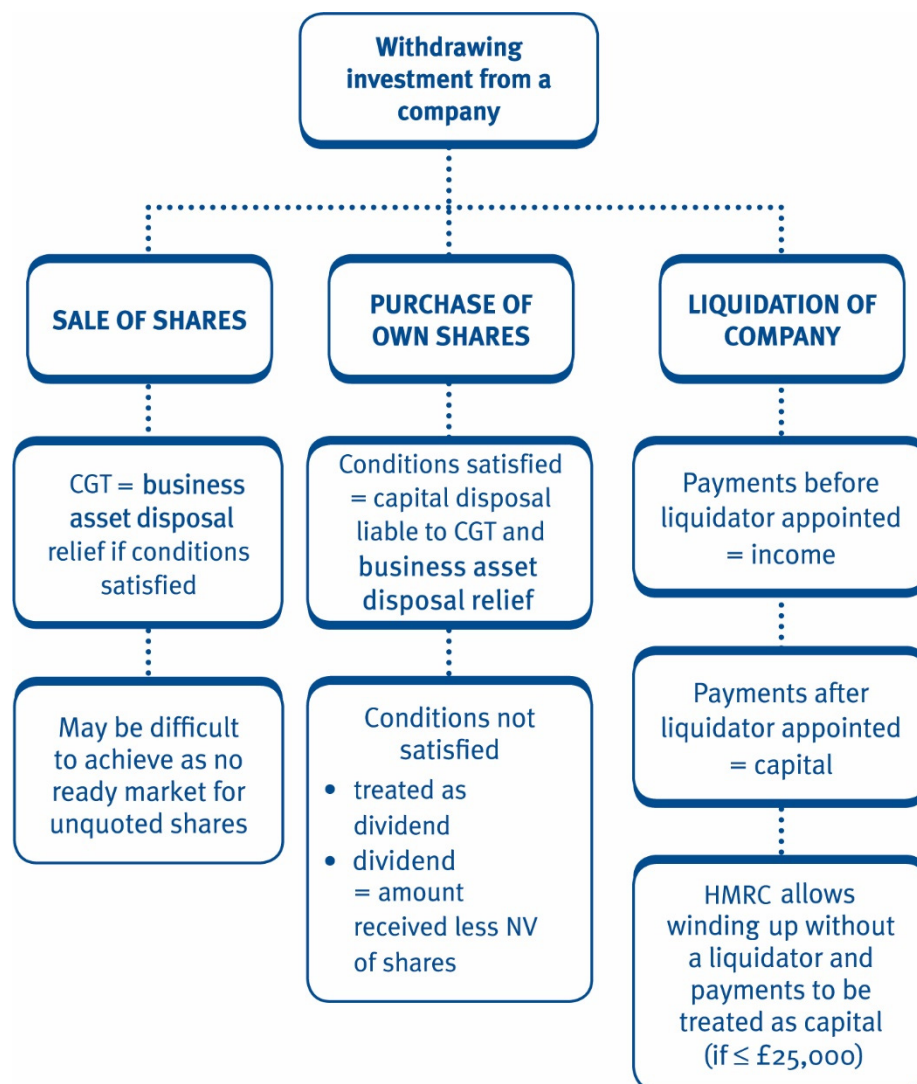
If the payment is more than £25,000, the whole amount will be treated as a distribution.



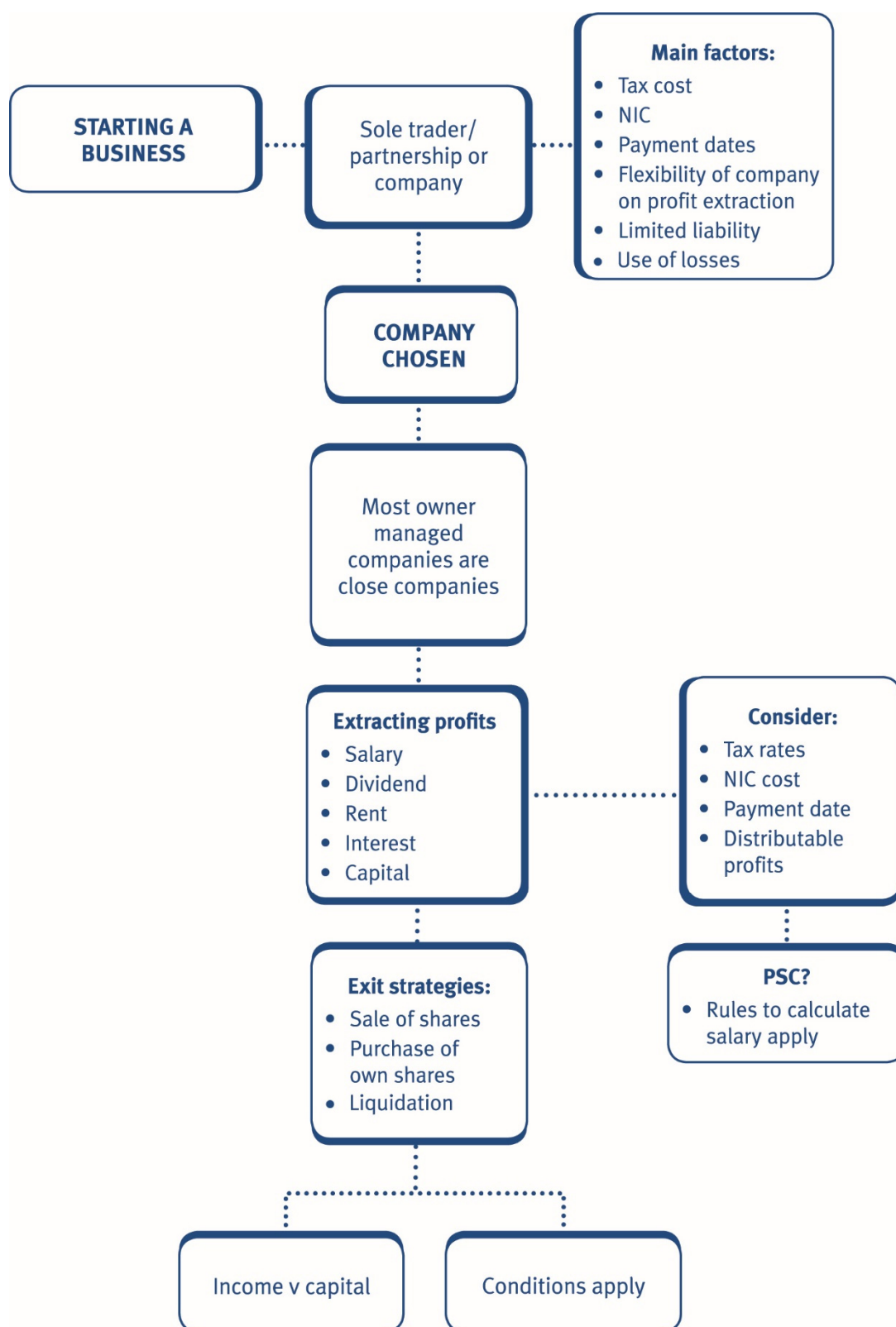
A major element in the planning of a liquidation is deciding whether the investment should be withdrawn in a form treated as income, or capital.

For an individual who is a higher or additional rate taxpayer the capital route would normally be preferred as the tax rate will be 20% (10% if the disposal qualifies for business asset disposal relief) compared to 33.75%/39.35% on a dividend.

Summary



6 Chapter summary



Test your understanding answers



Test your understanding 1

La Famille Ltd

The company is not controlled by its directors, as Hugo is the only director and only has 20% of the shares.

It is, however, controlled by five or fewer shareholders, as follows:

	% shares
(1) Jeanette (plus associates Arthur and Louis)	23
(2) Hugo	20
(3) Cecile	5
(4) Felicity	4
	<hr/>
	52
	<hr/>

Between them, the four largest shareholders (including their associates) own more than 50% of the shares, therefore La Famille Ltd is a close company.

If the shareholders were unconnected, the company would not be a close company as the five largest shareholders would only hold 48% (20% + 12% + 6% + 5% + 5%).



Test your understanding 2

Abdullah and Habiba

The provision of the company car to Abdullah, who is a director as well as a shareholder, has the following consequences:

- For Abdullah, there is an employment benefit, calculated as follows: $\text{Appropriate\%} = 16\% + ((100 - 55) \times 1/5) = 25\%$
Car benefit = $(£20,000 \times 25\%) = £5,000$.
- As Abdullah is a 40% taxpayer, this benefit will result in additional income tax of £2,000 ($£5,000 \times 40\%$), which will be collected through the PAYE system by adjusting his tax code. There are no employees' NICs payable on benefits.
- For Houghton Ltd, a capital allowance is available: $(£20,000 \times 6\%) = £1,200$, as emissions exceed 50g/km. Tax relief at 25% means that corporation tax will be reduced by £300.
- In addition, Houghton Ltd is liable to employers' NICs. The car benefit is subject to class 1A, on which the company gets tax relief. The class 1A charge is £690 ($£5,000 \times 13.8\%$). Tax relief at 25% means that corporation tax will be reduced by £173.

The provision of the company car to Habiba, who is not a director but who is a shareholder, has the following consequences:

Houghton Ltd	Habiba
<ul style="list-style-type: none"> No tax relief under the capital allowances system Dividend is deemed to be made Value of dividend is £5,000 ($£20,000 \times 25\%$) 	<ul style="list-style-type: none"> No taxable benefit as she is not an employee or director Dividend of £5,000 is taxed in the tax year 2023/24. Further charges will arise in subsequent tax years as long as a benefit continues The first £1,000 is covered by the dividend nil rate band, if available As she is a higher rate taxpayer, £1,350 ($£4,000 \times 33.75\%$) tax is due on the remaining dividends.



Test your understanding 3

Sally and Claire

	Sally	Claire
Is the amount loaned less than or equal to £15,000?	Yes	Yes
Is the individual is a full-time working employee?	Yes	Yes
Does the individual own 5% or less of the shares?	No	Yes
Therefore, is the loan caught by the close company provisions?	Yes	No

Sally

She has received the benefit of a low interest loan, for which under the employment income rules there is a benefit charge of £90 ($£12,000 \times (2.25\% - 1.5\%)$). This is the difference between the interest paid by Sally and the interest that would have been payable at the official rate of interest, based on the loan balance outstanding during the tax year.

The loan to Sally is caught by the provisions as she has 5% or more of the company's shares. Therefore, White Ltd will be required to pay a £4,050 ($£12,000 \times 33.75\%$) tax charge on 1 January 2025. If any part of the loan is repaid before 1 January 2025 then the tax charge is reduced accordingly.

The £4,050 will be recoverable by White Ltd when the loan is repaid, or written off.

Claire

The loan is not caught by the close company provisions (see above), but it will still be caught by the employment income benefit provisions.

Using the average method, the benefit is calculated as:

Average loan = (£12,000 + £8,000) × 1/2 = £10,000	
Interest on average loan (2.25% × £10,000)	£ 225
Less: Interest actually paid	
(£12,000 × 1.5% × 9/12) + (£8,000 × 1.5% × 3/12)	(165)
Loan benefit	<u>60</u>

Claire may elect for the precise method to be used if the benefit is lower.

HMRC also have the right to impose the precise method but would only do so if the repayment pattern was not commercial or designed to reduce the benefit. This does not appear to be the case here.

**Test your understanding 4****Fletcher Ltd**

	£	Salary £	Dividend £
Profit available for Norman		50,000	50,000
Salary	43,937		
Employer's NICs (13.8/113.8 × £50,000)	6,063		
	<u> </u>	(50,000)	
TTP		<u>0</u>	<u>50,000</u>
Corporation tax at 25%		0	12,500
Profit available if dividend is paid			<u>37,500</u>

Note that the £5,000 NIC employment allowance is not available if Norman is the sole employee earning over £9,100. However, even if he is not, in this example it is assumed that if the allowance were available, it has already been claimed.

Norman

Norman is a higher rate (HR) taxpayer having already received a salary of £52,000.

	Salary £	Dividend £
Additional salary	43,937	
	<hr/>	
Dividend		37,500
		<hr/>
Income tax		
£43,937 × 40%	17,575	
£1,000 × 0% (Dividend nil rate band)		0
£36,500 × 33.75%		12,319
Class 1 NICs (£43,937 × 2%)	879	0
	<hr/>	<hr/>
	18,454	12,319
Net after tax income for Norman		(Note)
Salary (£43,937 – £18,454)	25,483	
Dividend (£37,500 – £12,319)		25,181

Note: Alternative calculations

The after-tax income in each scenario can be calculated much quicker if you work 'in the margin' using marginal rates of tax. As a higher rate taxpayer:

- Additional salary will be taxed at 42% (40% IT and 2% NICs) therefore Norman will receive 58% after tax
 $= (£43,937 \times 58\%) = £25,483$
- Additional dividend in excess of the first £1,000 will be taxed at 33.75% therefore Norman will receive 66.25% after tax plus £1,000
 $= (£36,500 \times 66.25\%) = £24,181 + £1,000 = £25,181$



Test your understanding 5

Brianna

(a) Employment income, income tax and employer's NICs

	£
Total contract value earned	70,000
Less: Statutory deduction (5%)	(3,500)
	<hr/>
	66,500
Less: Salary	(25,000)
Employer's NICs	(2,194)
	<hr/>
Deemed salary including employer's NICs	39,306
Less: Employer's NICs ($£39,306 \times 13.8/113.8$)	(4,766)
	<hr/>
Deemed employment income	34,540
	<hr/>
Income tax:	
£	£
$25,270 \times 20\%$ (W)	5,054
$9,270 \times 40\%$	3,708
	<hr/>
34,540	
	<hr/>
Income tax on deemed employment income	8,762
	<hr/>

Working: Basic rate band remaining

	£
BR band	37,700
Less: Taxable income ($£25,000 - £12,570$)	(12,430)
	<hr/>
BR band remaining	25,270
	<hr/>

(b) **Conrad Ltd**

Corporation tax liability – year ending 31 March 2024

	£
Trading profit	70,000
Less: Staff costs (£25,000 + £2,194)	(27,194)
IR35 costs (£34,540 + £4,766)	(39,306)
	<hr/>
TTP	3,500
	<hr/>
Corporation tax at 19% (Note)	665
	<hr/>

Note: Corporation tax will be payable at the small profits rate since augmented profits are below £50,000.



Test your understanding 6

Gok

	£
Payment in respect of services provided (net of VAT)	20,000
Less: Direct cost of materials incurred by the PSC	(500)
	<hr/>
Deemed direct payment (DDP)	19,500
	<hr/>

The DDP will be subject to income tax, employee NICs and employer's NICs. This would be calculated in the same way as if Gok was a direct employee of Bless plc.



Test your understanding 7

Bliss Ltd

(a) The income treatment applies

Hamza will be treated as receiving a dividend on 1 April 2024 and will be subject to income tax in the tax year 2023/24 as follows:

	£
Cash received	600,000
Less: Original subscription price	(3,000)
	<hr/>
Net distribution = deemed dividend received	597,000
	<hr/>
Income tax:	
First £1,000	0
Next £61,570 × 33.75% (Note 2)	20,780
(£597,000 – £61,570 – £1,000) × 39.35%	210,298
Plus: Loss of PA (£12,570 × 40%) (Note 1)	5,028
	<hr/>
Total tax payable	236,106
	<hr/>

Due date 31 January 2025

Notes:

- (1) The PA will also be restricted to £Nil as ANI exceeds £125,140, therefore other taxable income will increase by £12,570 to £62,570, and the loss of the PA will affect the total tax implications of the deemed dividend received.
- (2) The first £1,000 of dividends is taxed at 0%, but uses part of the higher rate band. Therefore, the remaining higher rate band is:

	£
HR band limit	125,140
Other taxable income (Note 1)	(62,570)
First £1,000 dividends	(1,000)
	<hr/>
	61,570
	<hr/>

(b) The capital treatment applies

Hamza will be liable to capital gains tax as follows:

	£
Sale proceeds	600,000
Less: Cost	(3,000)
	<hr/>
Gain qualifying for BADR	597,000
Less: AEA	(6,000)
	<hr/>
Taxable gain	591,000
	<hr/>
Capital gains tax (£591,000 × 10%) (Note)	59,100
	<hr/>
Due date	31 January 2025

Note: BADR is available since Hamza owns at least 5% of a trading company where he works, and has owned the shares for at least two years.



Test your understanding 8

Simon

(i) Option 1

Pre-liquidation dividend – Income tax

	£	£
Dividend received	180,000	
	<hr/>	
Income tax: (First £1,000 × 0%)	0	
(£179,000 × 39.35%)	70,437	
	<hr/>	
	70,437	70,437

Post-liquidation distribution – CGT

Proceeds	540,000
Less: Cost	(1,000)
	<hr/>
Gain qualifying for BADR (Note)	539,000
Less: AEA (already used)	(0)
	<hr/>
Taxable gain	539,000

CGT payable (10% × £539,000)	53,900
------------------------------	--------

Total tax payable	124,337
-------------------	---------

(ii) Option 2 – CGT

	£
Proceeds	720,000
Less: Cost	(1,000)
	<hr/>
Gain qualifying for BADR (Note)	719,000
	<hr/>
CGT payable (10% × £719,000)	71,900

Note: Simon's shares qualify for BADR because he has owned at least 5% of a trading company where he works, and he has owned the shares for at least two years.

Business financial management

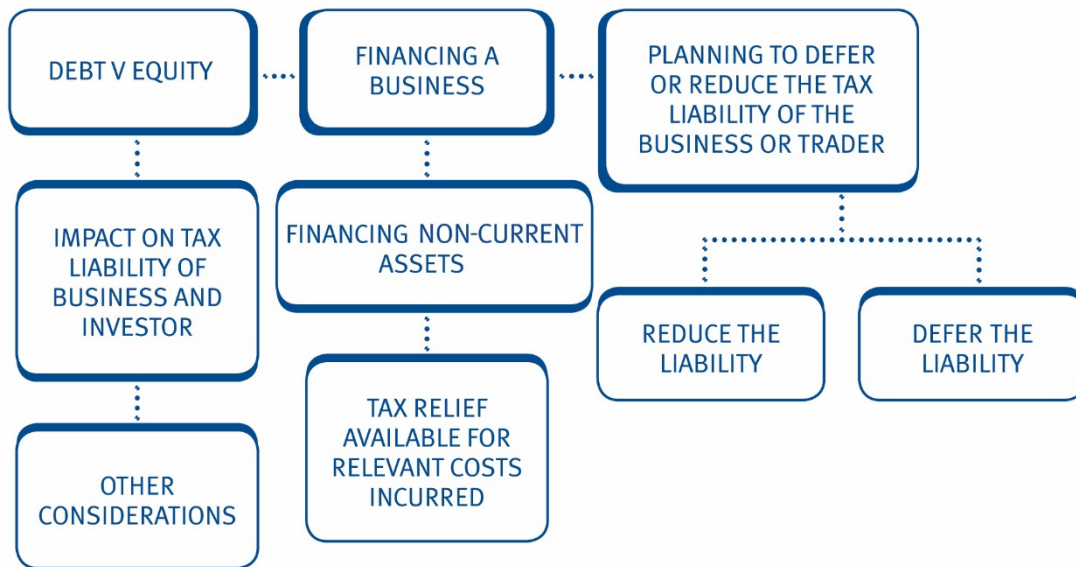
Chapter learning objectives

Upon completion of this chapter you will be able to:

- understand and explain the tax implications of the raising of equity and loan finance
- explain the tax differences between decisions to lease, use hire purchase or purchase outright
- understand and explain the impact of taxation on the cash flows of a business
- identify and advise on the types of investment and other expenditure that will result in a reduction in tax liabilities for an individual and/or a business.



One of the PER performance objectives (PO17) is to advise on mitigating and deferring tax liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate that objective.



Introduction

This chapter deals with the way in which sole traders or partnerships, and companies can raise finance. Non-current asset financing is also considered.

The tax implications and other commercial considerations that should be borne in mind when deciding how to finance the business are discussed. Many of these tax implications you would have studied in TX, but the emphasis in ATX is on knowing how to apply them in a given scenario.



1 Business finance

Financing a company – long-term finance

A company can raise long-term finance to fund its activities from:

- Shareholders (equity).
- Third party loan finance, sometimes by way of an issue of loan notes (debt).

The effect of each of these is different from the company's perspective.

However, the requirements of the investors also need to be taken into account, and these will vary depending on whether they are individuals or other companies.



The main considerations for the company raising the finance will be:

- funding the interest payments or dividends that will result
- the security required by the lenders – they may require a charge on company assets which would be exercised if the company failed to meet its obligations with regard to income and/or capital repayments.

Comparison between the use of equity or debt

A summary of the main differences between using these two methods of finance is as follows:

	Equity	Debt
Amount	<p>The maximum issued share capital is</p> <ul style="list-style-type: none"> • specified in the Statement of Capital which is submitted on registration • Increased with shareholder approval. 	<p>There is no limit to the amount of finance that can be raised in debt, other than the amount the investors are prepared to invest.</p>
Return	<p>Dividends</p> <ul style="list-style-type: none"> • The company must have distributable profits to pay a dividend. • The dividend payment is not allowable for corporation tax. 	<p>Interest</p> <ul style="list-style-type: none"> • Interest must be paid irrespective of the company's profitability. • It is deductible on an accruals basis. • Interest is paid net of 20% tax if it is paid to an individual in respect of an unquoted loan note. • Companies receive interest gross.
Corporate Investors	<ul style="list-style-type: none"> • No CT on dividends received. 	<ul style="list-style-type: none"> • Interest income (on an accruals basis) = part of TTP.

	Equity	Debt
Individual Investors	<ul style="list-style-type: none"> • A basic rate taxpayer – 8.75% IT liability on UK dividends received if not covered by £1,000 dividend nil rate band. • A higher rate or additional rate taxpayer – 33.75% or 39.35% liability if not covered by £1,000 dividend nil rate band. (Chapter 16) 	<ul style="list-style-type: none"> • A basic rate taxpayer – 20% liability on gross interest received if not covered by £1,000 savings income nil rate band (but interest paid net of 20% tax if in respect of an unquoted loan note). • A higher rate taxpayer – 40% liability if not covered by £500 savings income nil rate band. • An additional rate taxpayer – 45% liability (note: no savings income nil rate band). (Chapter 16)
Other points	<ul style="list-style-type: none"> • Companies that are not listed on the Stock Exchange may find it difficult to raise finance with a new issue of shares. • For an owner managed business the existing shareholders may not be prepared to accept outside shareholders that could dilute their control of the company. • In this case new share issues will probably be to existing shareholders and their family members. 	<ul style="list-style-type: none"> • A lender may require a charge on assets as security for the debt. • If the company defaults on either the interest or the capital that charge can be called in, and the assets of the company sold to finance the outstanding amounts. • Default can also lead to the liquidation of the company



Illustration 1 – Debt vs. Equity

M Ltd is an unquoted trading company set up a number of years ago with 1,000 £1 ordinary shares issued at par. In order to expand the production facilities it needs to raise a further £50,000.

There are **two** possibilities:

- 1 The company will issue a further 50,000 5% preference shares, which have a nominal value of £1 and a market value of £1 each.
 - 2 £50,000 loan notes will be issued at par. This will carry interest of 5% payable annually.
- (a) **Calculate the retained profit for the year ended 31 March 2024 on the assumption that:**
- the shares or loan notes will be issued on 1 April 2023
 - a full year's preference dividend will be paid in the year
 - no dividend is paid on the ordinary shares in the year
 - the profit before interest, tax and dividends is £150,000.
- (b) **Calculate the net return for the investor on the assumption that:**
- the investor is an individual who is a higher rate taxpayer and does not receive any other dividends or savings income
 - the investor is a company that pays tax at 25%.

Solution

(a) **Retained profit – y/e 31 March 2024**

	Equity £	Debt £
Profit	150,000	150,000
Less: Interest (5% × £50,000)		(2,500)
	<hr/>	<hr/>
	150,000	147,500
Less: CT at 25%	(37,500)	(36,875)
	<hr/>	<hr/>
	112,500	110,625
Less: Dividend (5% × £50,000)	(2,500)	
	<hr/>	<hr/>
Retained profit	110,000	110,625
	<hr/>	<hr/>

(b) Return		
Individual investor		
	Equity	Debt
	£	£
Dividend income	2,500	
	<hr/>	
Gross interest income ($£2,000 \times 100/80$) (Note)		2,500
		<hr/>
IT at 0% on dividend (DNRB) (first £1,000)	0	
IT at 33.75% on dividend (remaining £1,500)	506	
IT at 0% on savings (SNRB) (first £500)		0
IT at 40% on interest (remaining £2,000)		800
IT credit ($20\% \times £2,500$)		(500)
	<hr/>	<hr/>
IT payable	506	300
	<hr/>	<hr/>
Income after tax:		
Dividend ($£2,500 - £506$)	1,994	
	<hr/>	
Interest ($£2,000 - £300$)		1,700
		<hr/>
Note: Companies deduct 20% income tax at source when they pay interest to an individual in respect of an unquoted loan note.		
Corporate investor		
Dividend received	2,500	
Interest received		2,500
CT at 25%	0	(625)
	<hr/>	<hr/>
After tax income	2,500	1,875
	<hr/>	<hr/>

Incentives to invest in shares

HMRC offer tax-advantaged schemes where the issuing company meets certain conditions. These schemes allow the investor tax relief on the investment, and/or when the shares are sold and may therefore make the share issue more attractive to potential investors.

The most important of these schemes are:

		Chapter	Applies to
Enterprise Investment Scheme	EIS	18	Individual investors
Seed Enterprise Investment Scheme	SEIS		
Venture Capital Trusts	VCT	18	Corporate investors
Substantial Shareholding Exemption	SSE	2	

Drawbacks of investing in shares

If the investment is wholly by way of equity, no return can be received by the investor until the company becomes profitable, whereas interest must always be paid irrespective of the company's profitability. Therefore, investors may prefer purchasing loan notes to shares as they have more certainty of a return. However, interest returns tend to be fixed, whereas, dividends could increase substantially with profits.

As a result investors may wish to invest using a mix of debt and equity, especially where they are investing in a new company, which may not yet have distributable profits.

Financing a sole trader or partnership



There are two main sources of finance for unincorporated businesses (i.e. where the business is owned by the individual sole trader or partners in a partnership):

- the individuals themselves
- loans from banks and other financial institutions.

Financing by the individuals:

- An individual may have funds to invest in the business as capital.
- If the individual is a sole trader there is no interest charged to the business by the individual, as the individual is entitled to all of the profits of the business.
- In a partnership the profit sharing arrangements would reflect the amount invested by each partner in the business. However, any interest paid to partners is not deducted from trading profits.

Financing from a loan:

- A bank may be prepared to lend money to an individual to invest in a business. Interest relief against total income is available on this borrowing where the individual borrows money:
 - to invest in a partnership, of which the individual is a partner
 - to buy plant and machinery for use by a partnership of which the individual is a partner. In this case, relief is available in the tax year of purchase and the following three years.
- Many sole traders rely on short term financing such as bank overdrafts. The interest is deducted from the business profits as an expense.
- Most lenders will require some form of personal guarantee before they will lend money or allow an overdraft facility to a sole trader or partnership. If the business fails, the individual will then be responsible for repaying the debt from personal resources.

Short-term finance

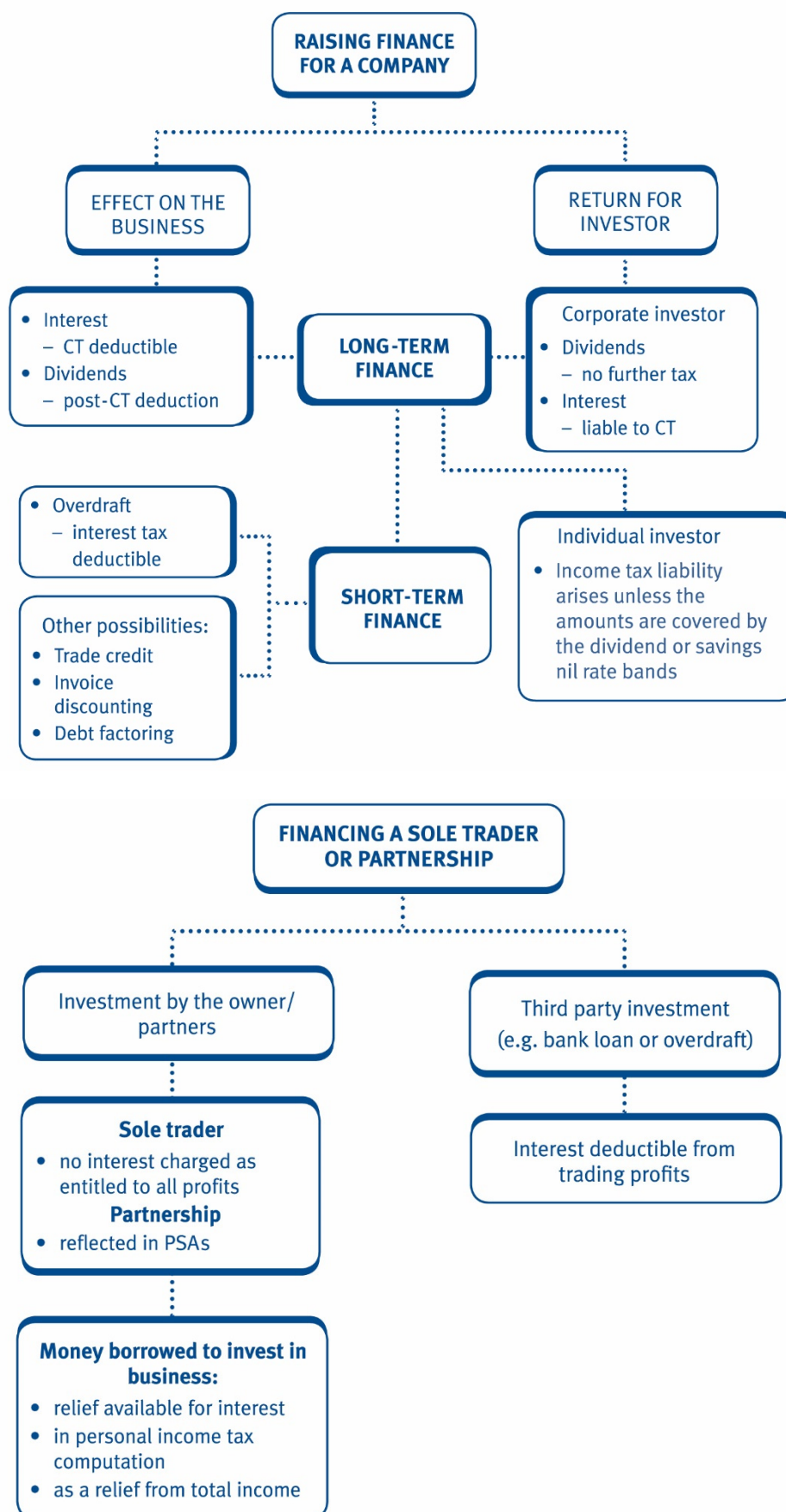
Sources of short-term finance are:

- bank overdraft – interest allowed as a deduction from trading profits
- short-term loans – as for debt except interest is always paid gross to both individuals and companies
- trade credit – not utilising cash balances to pay for purchases increases a credit balance or reduces the overdraft
- invoice discounting
- debt factoring
- hire purchase and leasing.

Invoice discounting is where a company sells its receivables to a third party who pays the company an amount after deducting a service charge. The company will have to reimburse the money if the debt becomes irrecoverable.

Debt factoring is where the company sells its debt outright, and the debt factors take the risk of irrecoverable debts. The cost charged to the company is usually higher than where it uses invoice discounting.

Summary



2 Financing non-current assets

Most businesses will require the use of non-current assets to function efficiently.

There are three main ways of financing the purchase:

- Outright purchase.
- Hire purchase.
- Leasing.

Outright purchase

If the asset is bought by the business from its existing resources:

- Many of these assets will qualify for capital allowances, with businesses entitled to the annual investment allowance (AIA) in the year of purchase (Chapters 2 and 21).
- The initial cost has to be met up front but the trader will receive the proceeds of sale when the asset is sold.
- VAT will be recoverable providing the business is registered and it is not irrecoverable VAT (e.g. cars).

Hire Purchase (HP)

Acquisition under an HP agreement is treated as an outright purchase but the HP company effectively provides the finance.

- The asset is capitalised by the business.
- Capital allowances are available on the cost (excluding interest) of the qualifying assets.
- The amount of the purchase price not met with the initial payment is then a liability for the business to repay.
- Each instalment paid is part interest and part capital.
- The interest element is tax deductible, and the capital portion reduces the liability.
- Once the final payment is made the asset legally belongs to the trader, and the trader will receive any proceeds of disposal.
- Again, providing the business is VAT registered they will be able to claim the VAT on the purchase cost of the asset.
- There is no VAT on the instalments as they are effectively relating to financing which is an exempt activity.

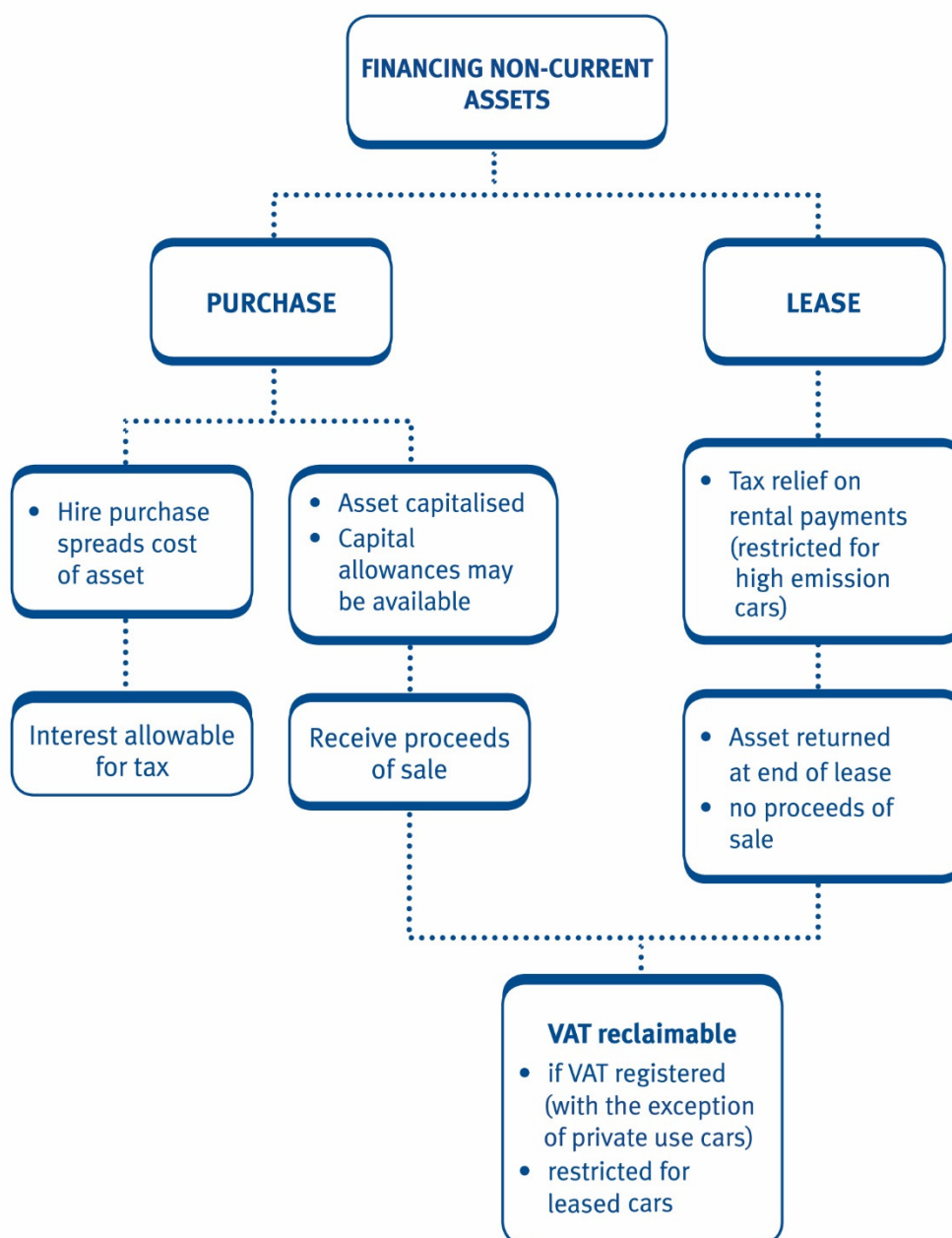
HP therefore achieves the same outright ownership of the asset but without the up-front cost. The overall cost will be greater as the interest has to be paid but it is spread over the period of the HP contract.

Leasing

Where an asset is leased:

- The business pays a rent, which is deductible for tax purposes.
- Tax relief is given when the payments are debited to the statement of profit or loss, and these are spread using the normal accounting principles.
- The asset returns to the leasing company at the end of the lease. Accordingly, there are
 - no proceeds of sale
 - no problems trying to find a buyer when the asset is no longer required.
- VAT is recovered by a VAT registered business.
- Where the asset is a high emission car there is a restriction on the tax relief available on the rental payments. In addition, usually only 50% of the VAT can be reclaimed on any car lease payments.

Summary



3 Deferring or reducing the tax liability of a business

There are a number of ways of reducing or deferring a tax liability incurred by a business.

For a quoted company it is necessary to consider the effect of these measures on the company's net profit as this will affect its ability to pay dividends, and possibly its share price.

Factors to consider are covered in detail in other chapters. A summary of the key factors to consider is given below and the considerations are summarised in the chapter summary.



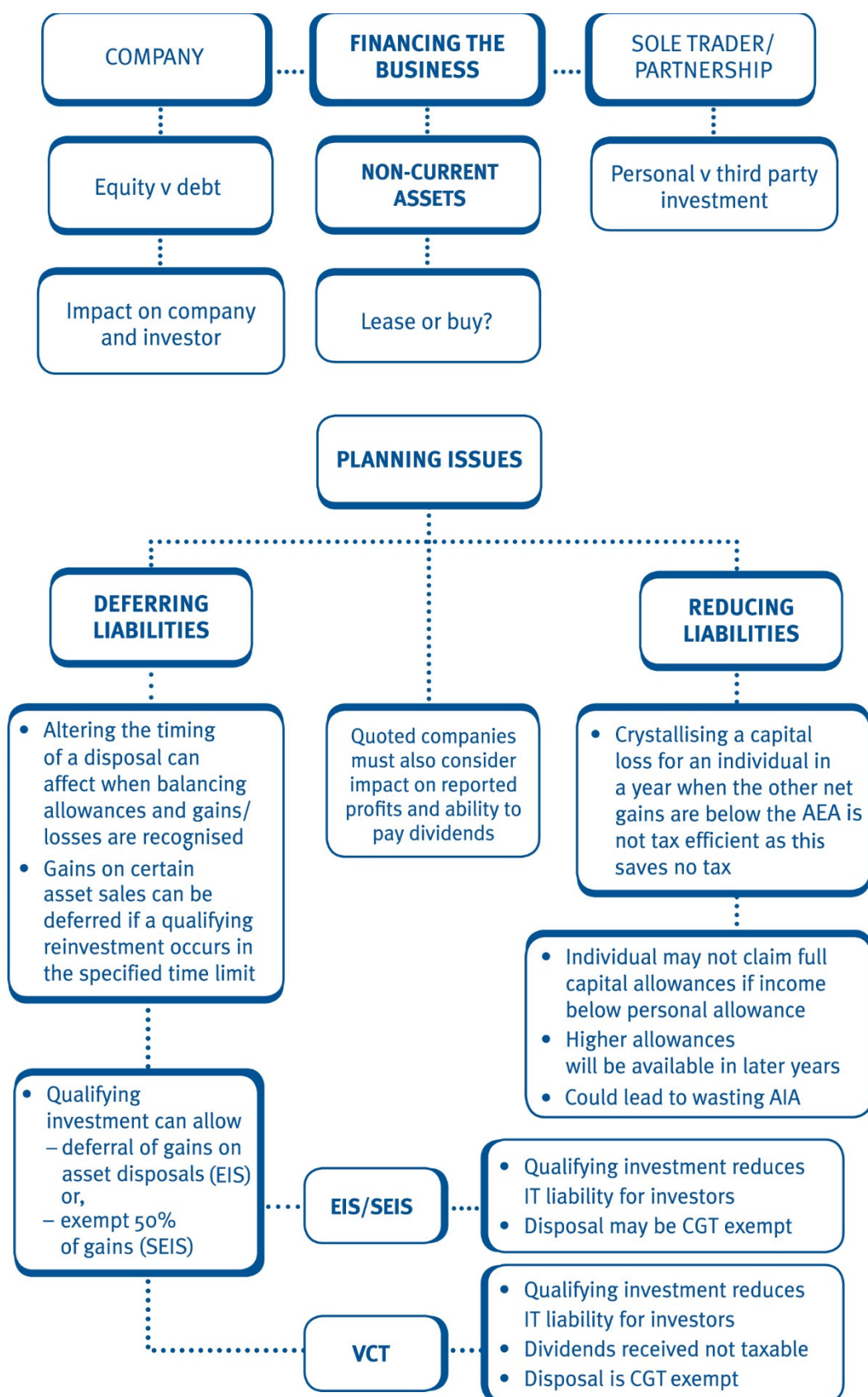
Key factors

The following factors may be considered:

- The disposal of non-current assets may create a balancing allowance (BA) or charge (BC). The timing of the disposal should be considered to see whether a BA can be accelerated into the current year and a BC delayed until the next.
- Similarly there may be a capital gain or loss. Will the timing of the disposal affect the date on which the tax is payable or any loss relieved?
- Where the capital disposal is by an individual, the availability of the annual exempt amount (AEA) (Chapter 6) should be considered. If the individual has a gain in the year, and there is to be a disposal that will create a capital loss, there is no point in crystallising the loss if the gain is already below the AEA and so no tax is payable.
- Where an individual has low income in a year the personal allowance (PA) (Chapter 16) may be wasted. In this situation the individual could consider not claiming all of the capital allowances available. If the full amount is not claimed the pool balance carried forward will be higher, and so greater allowances will be available in subsequent years. However, any entitlement to AIA or FYA not claimed, cannot be claimed in a subsequent year.
- Where the business sells an asset will there be a qualifying replacement purchased within the required time limit? If so, the gain can be deferred using rollover relief. Where the business is part of a group of companies the replacement can be made by any member of the gains group.
- Similar considerations apply where a company sells an intangible asset and replaces it with a further intangible asset.

- EIS and SEIS reinvestment relief (Chapter 18) reduce the current year's income tax liability. However, it is difficult to withdraw from an EIS/SEIS investment as they are unquoted shares. In addition, EIS/SEIS companies tend not to pay dividends and retain their profits to increase the gain on disposal, as the gain should be exempt if the conditions are met.
- An investment in EIS shares may allow a gain on another disposal to be deferred. It will become chargeable when the EIS shares are sold (Chapter 18).
- An investment in SEIS shares may exempt up to 50% of the gain (Chapter 18).
- VCTs are a better investment in this context as they will pay dividends (exempt income), and because they are quoted companies it should be possible to realise the investment when needed. However, they are considered to be a risky investment and should not be used by someone who cannot afford to lose the investment (Chapter 18).

4 Chapter summary



VAT: Outline

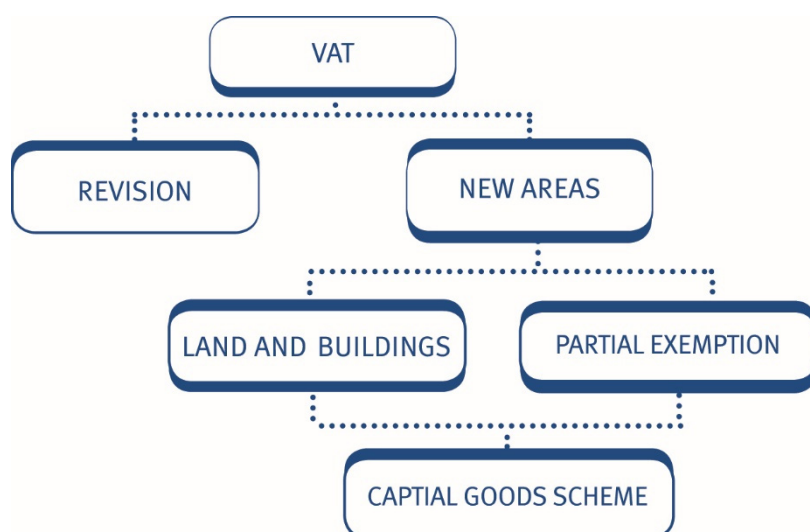
Chapter learning objectives

Upon completion of this chapter you will be able to:

- advise on the instances where VAT would be chargeable, including the instances where a business would be required to register for VAT
- calculate VAT payable/repayable taking into consideration a variety of different transactions
- advise on the VAT implications of the supply of land and buildings in the UK
- advise on the VAT implications of partial exemption
- advise on the application of the capital goods scheme



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. Working through this chapter should help you understand how to demonstrate that objective.



Introduction



This chapter and the next cover value added tax (VAT). The first part of this chapter revises the basic rules of VAT covered at TX.

The new topics introduced at ATX are shown in the diagram above.

1 A revision of basic VAT

The scope and nature of VAT

VAT is:

- an indirect tax on consumer spending
- charged on most goods and services supplied within the UK
- suffered by the final consumer, and
- collected by businesses on behalf of HM Revenue and Customs (HMRC).



Overview of how VAT works

VAT is collected by businesses at each stage in the production and distribution process of supplying goods and services as follows:

- businesses account to HMRC for the tax (known as output VAT) on sales
- if the customer is registered for VAT and uses the goods or services for business purposes, they can recover the tax they have paid on the purchase of the item or service (known as input VAT)
- accordingly, businesses actually account to HMRC for the tax on the 'value added' to the product at that stage of the process.

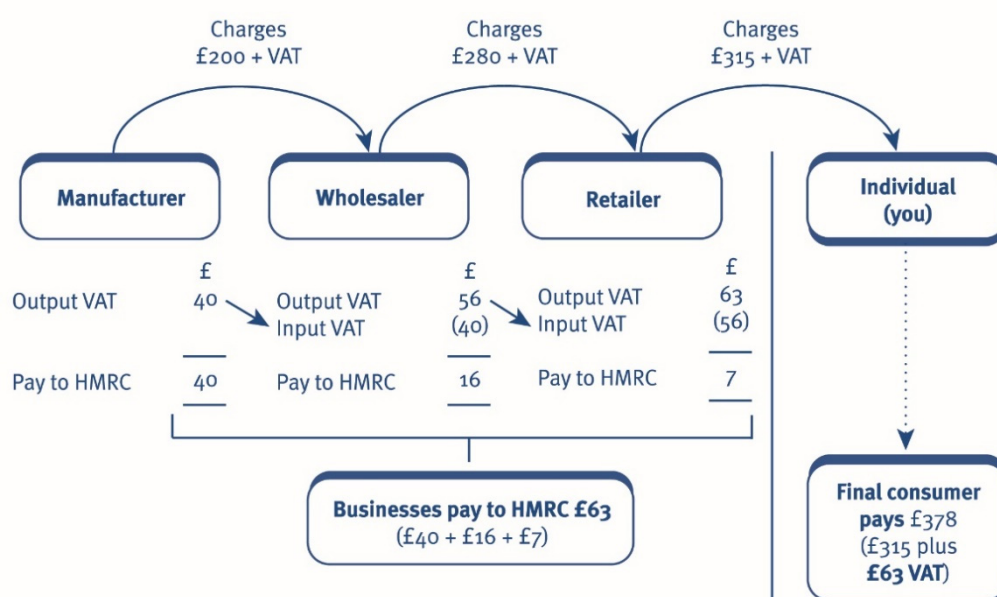
Businesses are merely acting as collectors of VAT on behalf of HMRC and they do not suffer any tax. It is only the final consumer who cannot recover the input VAT that suffers the tax.

How VAT works is shown in the illustration below.



Illustration 1 – How VAT works

Assume that the rate of VAT throughout is 20%.



VAT is only charged

- by **taxable persons**
- when they make **taxable supplies** in the course of their business.

VAT is not generally charged on non-business transactions.



Key terms

- A **taxable person** is one who is or should be registered for VAT because they make taxable supplies. A person can be an individual, a partnership or a legal person, such as a company.
- A **taxable supply** is any supply which is not exempt or outside of the scope of VAT. It includes sales of most goods and services, gifts and goods taken from the business for personal use.
- For VAT to apply, the taxable supply must be made in the course or furtherance of a business carried on by a taxable person.

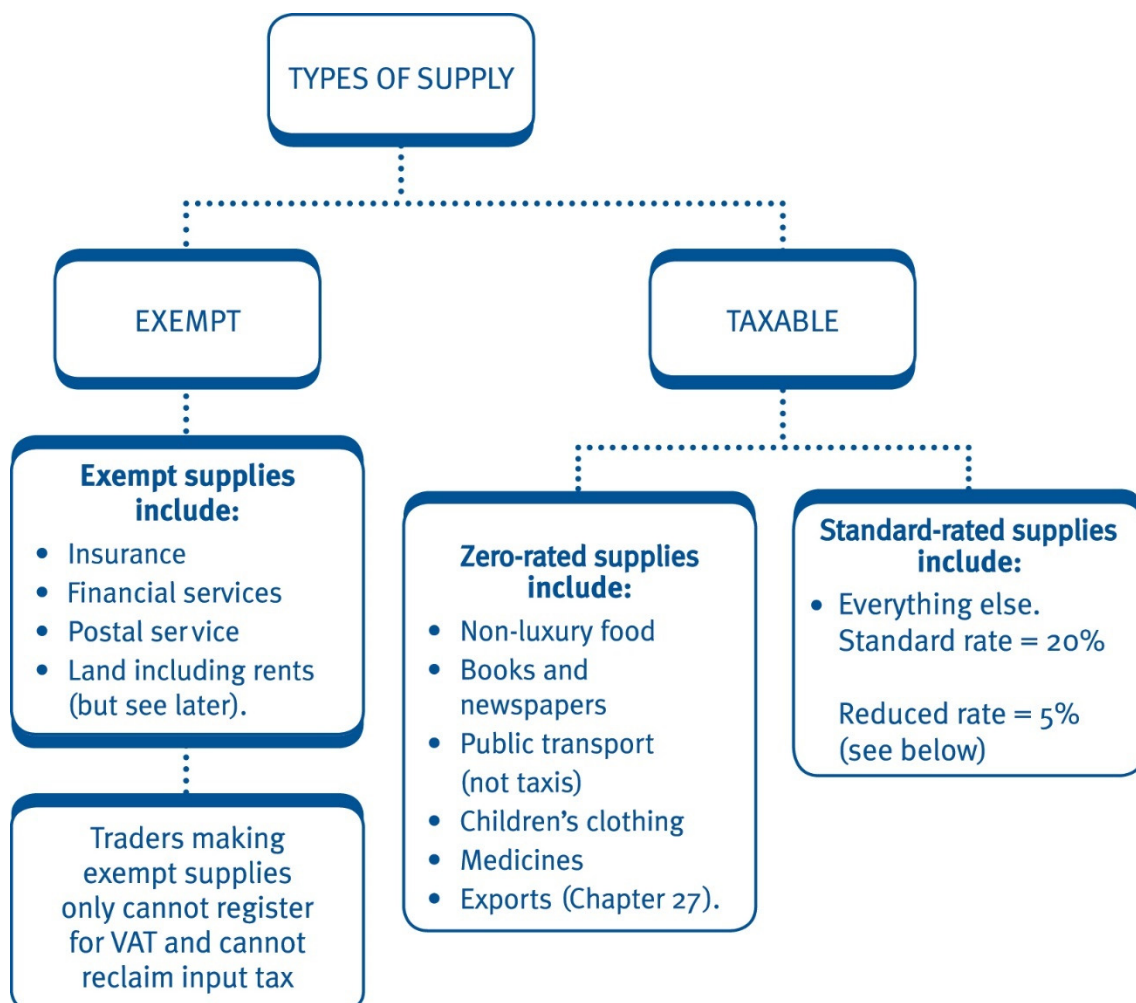
Input and output VAT

It is important to distinguish between input and output VAT:

- Input VAT is paid by businesses on their purchases and imports of goods and services.
- Input VAT is reclaimable from HMRC.
- Registered businesses charge output VAT on the supply of taxable goods and services. This includes gifts of goods (with some exceptions dealt with later) but not gifts of services. It also includes imports (Chapter 27).
- Output VAT is payable to HMRC.
- Every month or quarter the input and output VAT is netted off and paid to or recovered from HMRC.

Types of supply

VAT is charged on taxable supplies, but not on exempt supplies or those outside the scope of VAT.



Note that:

- Some taxable supplies, mainly domestic or charitable use, are charged at the reduced rate. These are not important for the examination.
- Some supplies are outside the scope of VAT. These include wages, shares, dividends, other taxes (e.g. road fund licence) and sales between members of a VAT group.



Mixed supplies

A mixed supply (or multiple supply) is where there are **individual elements** within the supply that are **treated separately** for VAT purposes.

The total amount payable for the supply must be **split** between the different elements, and then VAT charged at the appropriate rate on each element.

An example of a mixed supply would be fees charged to a football team that plays in a weekly league at a football stadium.

The team pays:

- a fee for the use of the stadium (exempt), and
- a separate fee to play in the league (standard-rated).

These two elements are treated as **separate supplies** rather than a single standard-rated supply of participation in a sports competition.



Composite supplies

A composite supply (or single supply) is where there is just **one supply** (with a single rate of VAT), even though the supply may be made up of lots of different things, each with different applicable rates of VAT.

A good example of a composite supply would be a flight with a meal provided.

Air transport is zero-rated and catering is standard-rated. However, a customer is buying a complete package, and it is difficult to separate the two elements.

The meal is also a small and insignificant part of the package. Therefore this would be classed as a **single supply** of air transport and would be **zero-rated** for VAT purposes.

This follows the Court of Appeal decision in the BA case: the court found that the supply of an aeroplane ticket with complimentary food is a single supply. This conclusion was reached because the airline provided a meal regardless of whether the customer wanted it, BA was not contractually obliged to provide the meal, and customers who declined the meal could not claim a refund.

VAT registration

If a person's taxable supplies exceed the registration threshold, then registration is compulsory.

Taxable supplies in this context means:

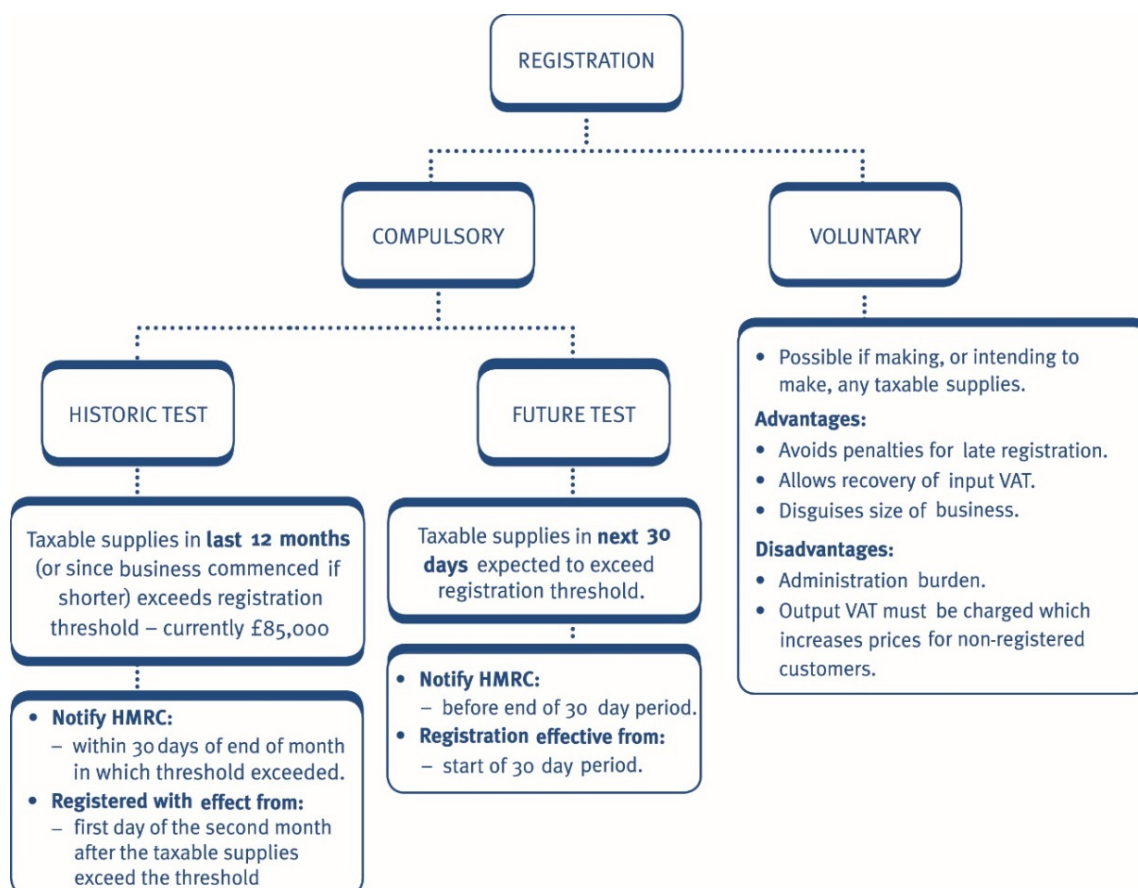
- all standard, reduced and zero-rated supplies (but not exempt supplies)
- excluding VAT, and
- excluding the sale of capital assets.

If a trader makes wholly zero-rated supplies, VAT registration is not compulsory, even if the registration threshold is exceeded.

Voluntary registration is possible. This is particularly useful for businesses as it allows the recovery of input VAT.

However care should be taken when selling to the public as VAT will then be added to the selling price.

A reminder of registration rules:



Note that:

- Registered traders are required to account for VAT.
- If a business fails to register in time, a penalty will be charged for late registration (see Chapter 27).
- A 'person' is registered for VAT (i.e. an individual, a partnership or a company).
- An individual sole trader has only one registration which covers all of the sole trader businesses that the individual carries on.
- A partnership is a separate person, therefore a partnership registration will cover all the businesses which are carried on by the same partners, but not any businesses they operate individually as sole traders.
- Companies are all registered individually, although it is possible to have a group registration (see below).
- It is possible to register, deregister and make variations to registration online. However, it is not compulsory to use the online service.

VAT groups



UK companies that are under common control can elect for a group VAT registration, provided that all the companies are trading in the UK via a permanent establishment.

A non-corporate entity (such as a partnership or a sole trader) can join a VAT group if it is the controller of a group of companies. In order to join a VAT group, the controlling entity must carry on a trade in the UK.

Definition of common control

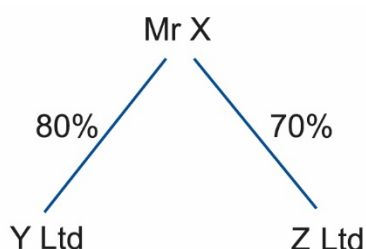
The definition of common control is the same as the definition of associated companies (see Chapter 1), in that common control exists if:

- a company controls another company or companies, or
- two or more companies are controlled by the same person (which could be a company or an individual), and
- where there is indirect control, the effective indirect interest does not need to be > 50%, there just needs to be > 50% interest at each link.

The key difference is that an individual is not counted as an associate, but may be able to join a VAT group.

Example

- Companies controlled by the same individual



Y Ltd and Z Ltd are associates.

Mr X, Y Ltd and Z Ltd can form a VAT group.

Consequences of a VAT group

A VAT group is treated as if it were a single company for the purposes of VAT.

Group registration is optional and not all members under common control have to join.

The effect of a group VAT registration is as follows:

- Goods and services supplied by one group company to another within the group registration are disregarded for the purposes of VAT. Therefore, there is **no need to account for VAT on intra-group supplies**.
- The VAT group appoints one company as a **representative member** which is responsible for accounting for all input and output VAT for the group.
- The representative member submits a **single VAT return** covering all group members, but all companies are jointly and severally liable for the group VAT payable.
- The normal time limits apply for submission of VAT returns.
- An application for group VAT registration has immediate effect, although HMRC has 90 days during which it can refuse the application.

Overseas companies with no UK permanent establishment cannot be part of a group VAT registration.

Transactions with such companies would be treated as imports/exports (see Chapter 27).

Advantages and disadvantages of group VAT registration

Advantages	Disadvantages
<ul style="list-style-type: none"> • VAT on intra-group supplies eliminated. • Only one VAT return required which should save administrative costs. • Flexible: do not have to include all group companies. • Companies which make exempt supplies can be included, which may allow recovery of input tax that would otherwise be irrecoverable (but see disadvantages). 	<ul style="list-style-type: none"> • All members remain jointly and severally liable for the group VAT. • A single return may cause administrative difficulties collecting and collating information. • The inclusion of a net repayment company (i.e. a company making wholly or mainly zero-rated supplies) would result in loss of monthly repayments. • Inclusion of an exempt company would cause the group to become partially exempt. This may restrict input tax recovery. • The limits for joining the cash accounting scheme (Chapter 26) are applied to the whole group rather than the individual companies. • The annual accounting and flat rate schemes are not available to companies registered as a group.

Pre-registration input VAT

Pre-registration input VAT can be recovered on the following:

- Goods (e.g. inventory and non-current assets):
 - if acquired for business purposes
 - in the last **four years**, and
 - goods are still in hand at the date of registration.
- Services:
 - if supplied for business purposes
 - in the **six months** prior to registration.

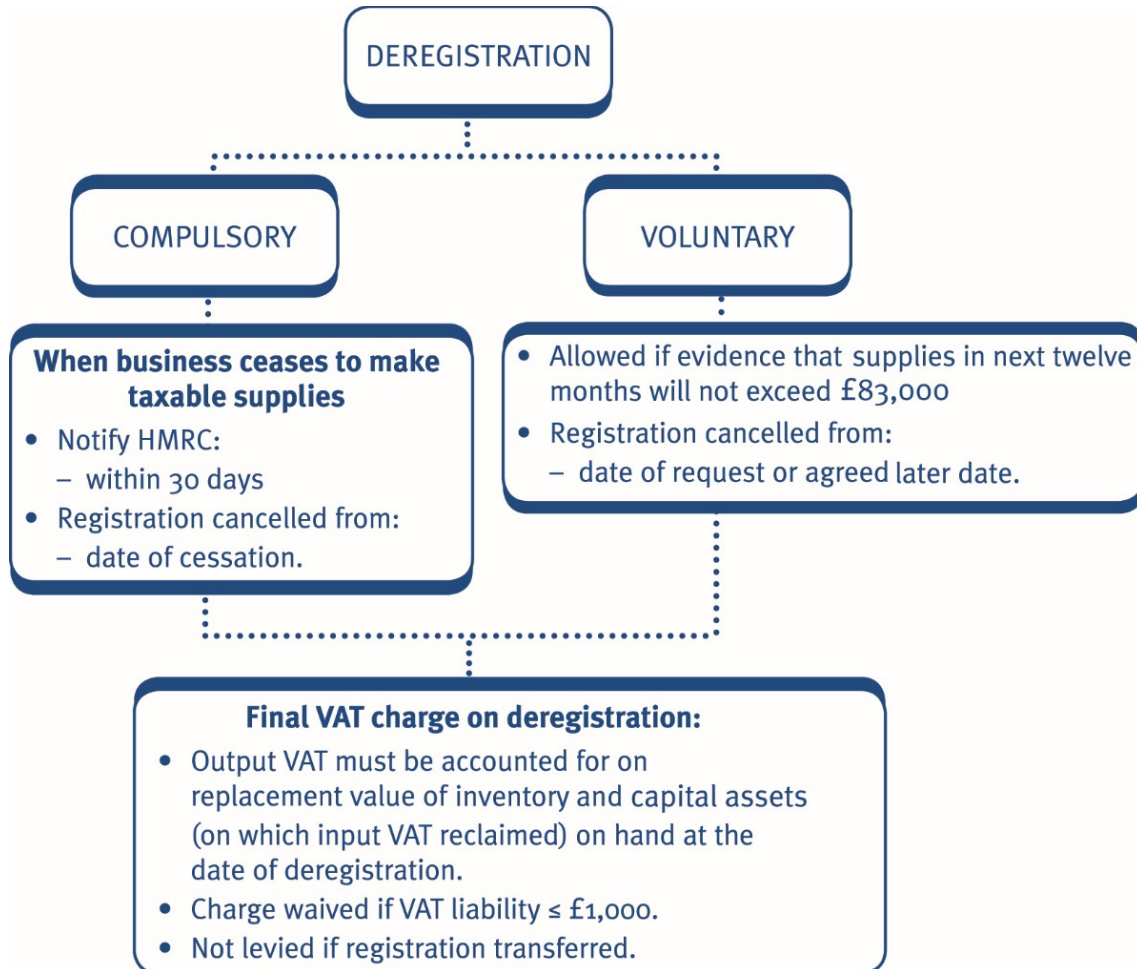
Deregistration

Deregistration is compulsory when a business:

- ceases to make taxable supplies, or
- is sold

although it is possible, by joint election, to transfer a registration to a new owner who assumes all rights and obligations in respect of the registration.

Voluntary deregistration is also possible.



VAT on the sale of a business

When a business is sold it will be necessary to charge VAT on the sale proceeds for taxable assets transferred. This is avoided if the transfer of going concern rules apply, in which case no VAT is charged (although see land and buildings below).

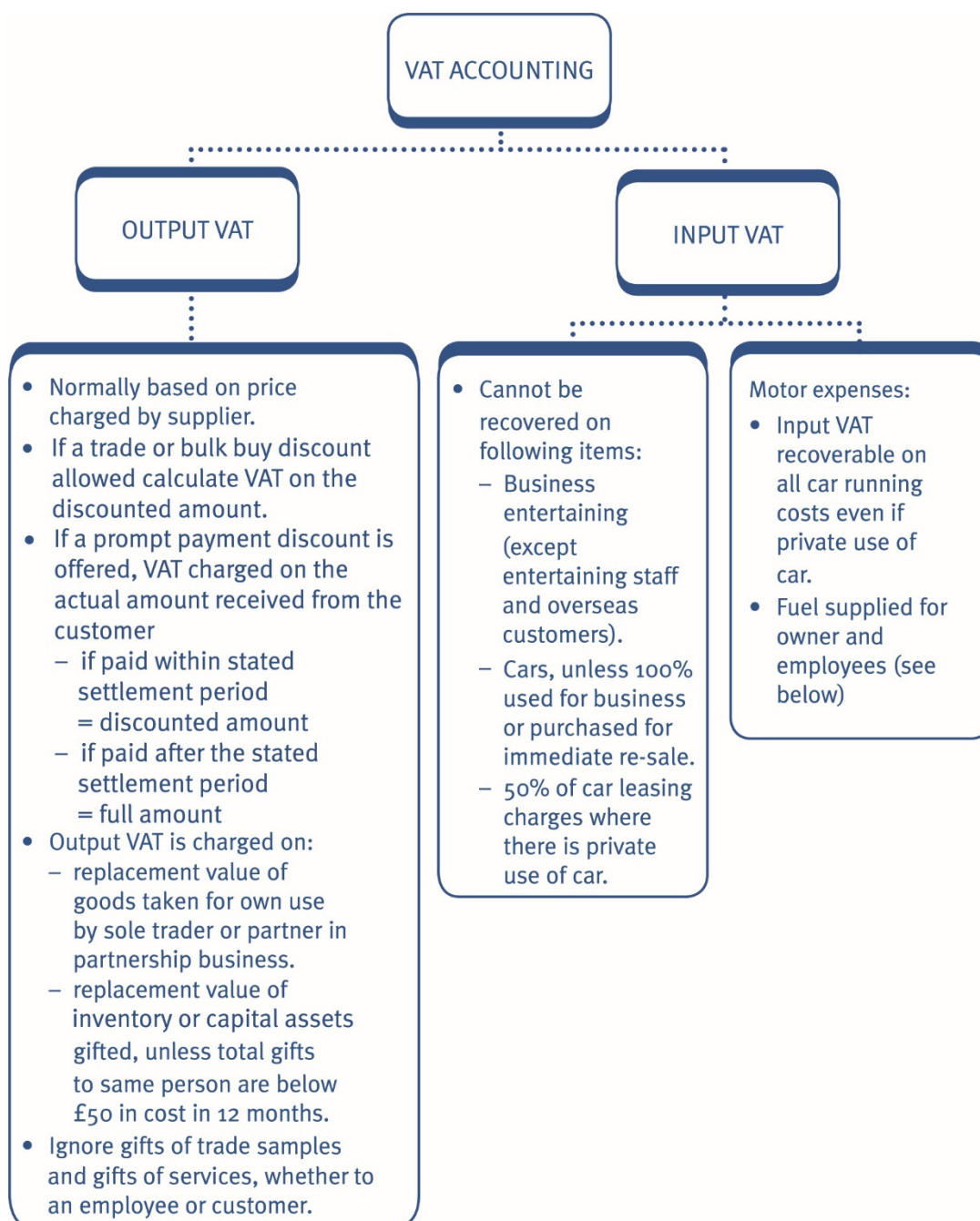
Conditions for transfer of going concern are as follows:

- The business is transferred as a going concern.
- There is no significant break in trading.
- The same type of trade is carried on after the transfer.
- The new owner is, or is liable to be, VAT registered immediately after the transfer. This condition is met if the new owner takes over the VAT registration of the seller.

Note that **all** of these conditions **must** be met.

Input and output VAT

This section deals with some of the special rules for determining the value of an output and reminds you of the purchases and expenses incurred by a business on which input VAT is not recoverable.

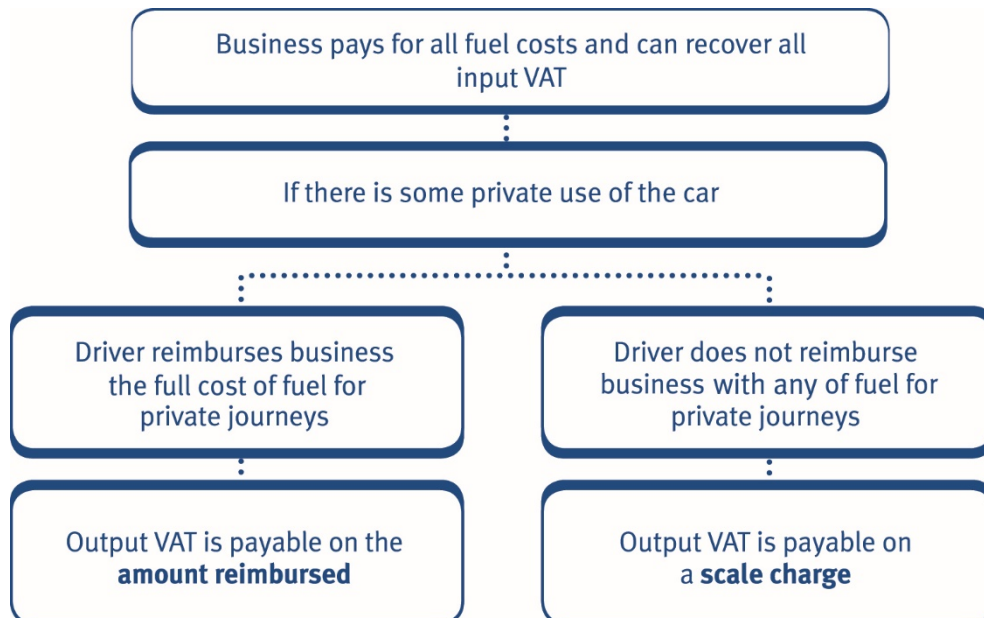


Note that output VAT is charged on the actual amount received from the customer if a prompt payment discount is offered.

Remember there is **no distinction** between capital and revenue expenditure for VAT.

Input VAT is recoverable on the purchase of capital assets (i.e. purchase of plant and machinery, vans, equipment etc.) as well as revenue expenditure (except for the 'irrecoverable items' in the diagram above).

Motor expenses – private fuel supplied by business



The fuel scale charge is based on the CO₂ emissions of the car and if relevant will be provided to you in the exam. The treatment of the scale charge is as follows:

- The VAT scale charge must be added to outputs in the VAT return, and the output VAT is borne by the business.
- The output VAT can be avoided
 - if no input VAT is recovered on the fuel, or
 - no private fuel is supplied.

Relief for impairment losses

Normally, VAT output tax is accounted for when an invoice is issued. If the debt becomes irrecoverable, the seller has paid VAT to HMRC and never recovers this from the customer.

This position is addressed by the seller being able to claim VAT relief for impairment losses, provided the following conditions are satisfied:

- **At least six months** must have elapsed since the payment from the customer was due (or the date of supply if later).
- The debt must have been written off in the seller's VAT account.
- Claims for relief for irrecoverable debts must be made within **four years and six months** of the payment being due.

Relief is obtained by adding the VAT element of the irrecoverable debt to the input tax claimed.

If there has been a series of supplies, any payments made by the customer must be allocated on a FIFO basis unless the customer allocated a payment to a particular supply and paid in full.



Test your understanding 1

- (1) Xioamei is a systems analyst who has recently started her own business. She has supplied you with the following information:
- (a) Her sales revenue for her first year ending 31 December 2023 is estimated to be £114,000 accruing evenly over the year. All Xioamei's customers are VAT registered businesses and all Xioamei's turnover is of taxable supplies.
 - (b) She purchased computer equipment for £3,150 including VAT on 14 January 2023.
 - (c) Her business telephone bills are estimated to be £360 per quarter including VAT.
 - (d) She uses a room at her home as her office. Her house has five main rooms and the electricity bill for the whole house for the year is estimated as £1,500 including VAT of £71.
 - (e) She has a petrol engine car which she uses 75% for business. Xioamei bought the car in October 2022 for £15,000 including VAT. It was valued at £13,500 when she started her business on 1 January 2023. The car emits 140g/km of CO₂ and annual running costs excluding petrol are £1,100 per year which includes £183 of VAT. She charges all her petrol costs through the business which amounts to £150 (VAT-inclusive) per month.
 - (f) Prior to starting in business, Xioamei paid her accountant £350 plus VAT on 1 December 2022 for drawing up cash flow projections. Her annual accountancy preparation costs are estimated to be £600 plus VAT.

For this part of the question assume today's date is 1 February 2023.

Xioamei has not yet registered for VAT. She wishes you to advise her when she will have to register compulsorily for VAT and whether it would be beneficial to register before that date.

For the remaining parts of the question assume that Xioamei has registered for VAT and that she has been trading for a few years.

- (2) In her second year Xioamei has problems collecting a debt from XYZ Ltd. She invoiced that company £3,500 including VAT, which was due for payment on 15 March 2024. In September 2024 she received £1,000 from XYZ Ltd in partial settlement of the debt but in October 2024 she wrote off the rest of the debt as irrecoverable.

Advise Xioamei of the VAT position on this debt.

- (3) In her third year of trading, Xioamei decided to offer a trade discount of 5%.

Explain to Xioamei what action she should take for VAT purposes when invoicing her customers.

- (4) Assume that instead of offering a trade discount, Xioamei offered a discount for prompt payment to try and improve her cash flow. The discount offered is 5% if invoices are paid within 14 days and 2.5% if paid within 30 days.

Explain how much output VAT should be charged if her customer pays after 21 days.

- (5) In her fourth year of business Xioamei receives an offer for her business of £450,000.

Xioamei wants you to advise her whether VAT needs to be charged on this amount and whether there are any other actions she should take. The projected sale date for the business is 31 May 2027.

Assume the VAT rules for the VAT year to 31 March 2024 apply throughout.

The VAT scale charge for a car with 140g/km of CO₂ emissions is £331 per quarter (inclusive of VAT).

VAT records

Records must be kept of all goods and services received and supplied in the course of a business. No particular form is specified, but they must be sufficient to allow the VAT return to be completed and to allow HMRC to check the return.

Records must be kept up-to-date and must be preserved for **six years**.

Following the introduction of Making Tax Digital VAT registered businesses are required to keep their VAT records electronically.

The details around Making Tax Digital are not examinable in the ATX exam.

In practice, the main records that must be kept are as follows:

- Copies of all VAT invoices issued.
- A record of all outputs (e.g. a sales day book).
- Evidence supporting claims for the recovery of input VAT (e.g. invoices).
- A record of all inputs (e.g. purchase day book).
- VAT account.

2 Special accounting schemes

There are three special VAT accounting schemes that are examinable and were covered at TX, namely:

- Cash accounting scheme
- Annual accounting scheme
- Flat rate scheme.

A brief reminder of these schemes is given below and is summarised in the diagram at the end of this section.



The cash accounting scheme

Under this scheme VAT is accounted for on the basis of amounts received and paid in the VAT period rather than the normal basis.

To be eligible for cash accounting the following conditions must be satisfied:

- The trader must be up-to-date with VAT returns and must have committed no VAT offences in the previous 12 months.
- The trader's taxable turnover, including zero-rated sales, but excluding VAT and excluding sales of capital assets, must not exceed £1,350,000 p.a.
- The trader must leave the scheme once taxable turnover (excluding VAT) in the previous 12 months exceeds £1,600,000 or is expected to exceed this level in the following 12 months.
- The limits for joining and leaving the cash accounting scheme are based on group figures where a VAT group is present
- The cash accounting scheme cannot be used for goods that are invoiced more than six months in advance of the payment date, or where an invoice is issued prior to the supply actually taking place.

The main advantages of cash accounting are:

- where customers are slow payers or there are irrecoverable debts no VAT is payable until the money is received (therefore automatic relief is obtained for irrecoverable debts)
- the information for the VAT return can be taken from the cash book, and no detailed cut-off procedures are required.

The main disadvantage is:

- the delay in the recoverability of input VAT which cannot be claimed until purchase invoices are paid.



The annual accounting scheme

This scheme alleviates the burden of administration of VAT and helps the cash flow of the business.

To be eligible to use the annual accounting scheme the same conditions as above must be satisfied.

The consequences of joining the scheme are as follows:

- Only **one VAT return** is submitted each year, but VAT payments must still be made regularly.
- Normally, **nine payments on account** of the VAT liability for the year are made at the **end of months 4 to 12** in that year.
- Each payment represents **10%** of the VAT liability of the previous year (or an estimated VAT liability for the year if a new business).
- A balancing payment (or repayment claim) is made at the same time as the annual return is filed, which must be **within two months** of the end of the annual return period.
- All payments must be made electronically
- The trader may apply to HMRC to agree quarterly payments on account instead of normal nine monthly payments.
- A business cannot join the annual accounting scheme if it is a member of a VAT group.



Flat rate scheme

A trader with **taxable turnover (excluding VAT) of £150,000 or less**, may account for VAT using the flat rate scheme, provided the trader has committed no VAT offences in the previous 12 months.

The consequences of the scheme are as follows:

- Under the flat rate scheme, the VAT liability due to HMRC is calculated as:

$$\text{a flat rate percentage} \times \text{total VAT-inclusive turnover}$$

(i.e. taxable and exempt supplies)
- No input VAT is recovered (although a claim can be made to recover VAT on purchases of capital assets that cost more than £2,000).

The need to calculate and record detailed output and input VAT information is therefore removed.

- The percentage varies according to the type of trade in which the business is involved and, if appropriate, will be given in the examination.

A higher flat rate of 16.5% applies to all types of business with limited, or no purchases of goods. You will not be expected to identify when to use this percentage but it could be provided to you in a question in the examination.

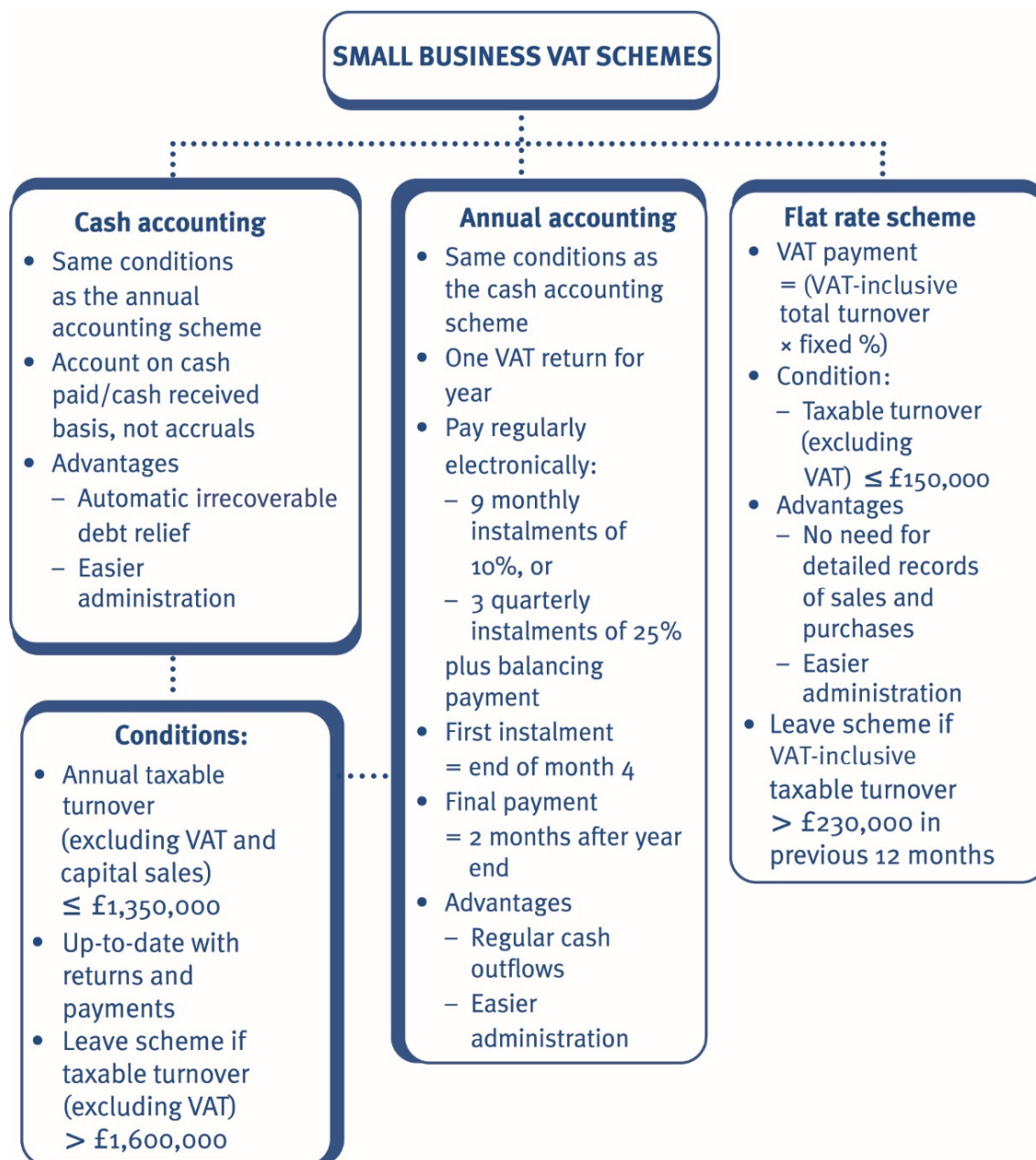
In the first year in which a trader is registered for VAT, a 1% discount on the normal percentage is given.

If a business incurs a considerable amount of input VAT the scheme will not be beneficial and the scheme should not be used.

- The flat rate scheme is **only** used to calculate the VAT due to HMRC. In other respects, VAT is dealt with in the normal way:
 - a **VAT invoice** must still be issued to customers and VAT charged at the appropriate rate (20% for standard-rated supplies)
 - a **VAT account** must still be maintained.
- The flat rate scheme can be used together with the annual accounting scheme.
- It is not possible to join both the flat rate scheme and the cash accounting scheme, however it is possible to request that the flat rate scheme calculations are performed on a cash paid/receipts basis.
- A business cannot join the flat rate scheme if it is a member of a VAT group.

A trader may stay in the scheme until the **total VAT-inclusive turnover** (i.e. taxable and exempt supplies) of the business for the previous 12 months exceeds **£230,000**.

Summary



Comprehensive example



Test your understanding 2

Vector Ltd is registered for VAT, and is in the process of completing its VAT return for the quarter ended 31 March 2024. The following information is available.

- (1) Sales invoices totalling £128,000 were issued in respect of standard-rated sales. Vector Ltd offers its customers a trade discount of 2.5%.
- (2) On 15 March 2024 Vector Ltd received an advance deposit of £4,500 in respect of a contract that is due to be completed during April 2024. The total value of the contract is £10,000. Both figures are inclusive of VAT.
- (3) Standard-rated expenses amounted to £74,800. This includes £4,200 for entertaining UK customers.
- (4) On 31 March 2024 Vector Ltd wrote off £12,000 due from a customer as an irrecoverable debt. The debt was in respect of three invoices, each of £4,000, that were due for payment on 15 August, 15 September and 15 October 2023 respectively. No discounts were offered on these sales.
- (5) On 1 January 2024 the company purchased a car costing £9,800 for the use of its sales manager. The sales manager is provided with free petrol for private mileage. The car has CO₂ emissions of 125g/km and the relevant quarterly scale charge is £276. Both figures are inclusive of VAT.

Unless stated otherwise all of the above figures are exclusive of VAT.

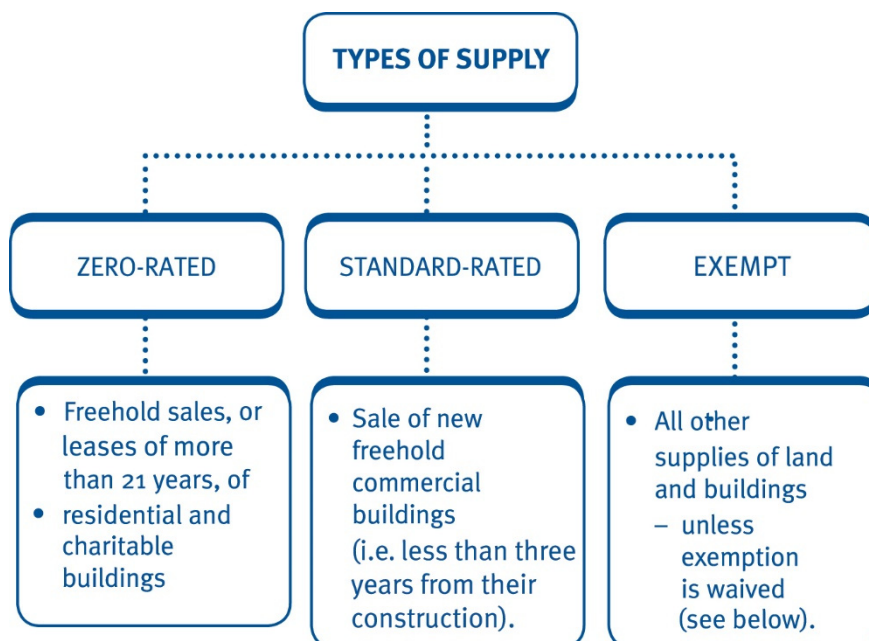
- (a) **Calculate the amount of VAT payable by Vector Ltd for the quarter ended 31 March 2024.**
- (b) **State the conditions that Vector Ltd must satisfy before it will be permitted to use the cash accounting scheme, and advise the company of the implications of using the scheme.**



3 Land and buildings

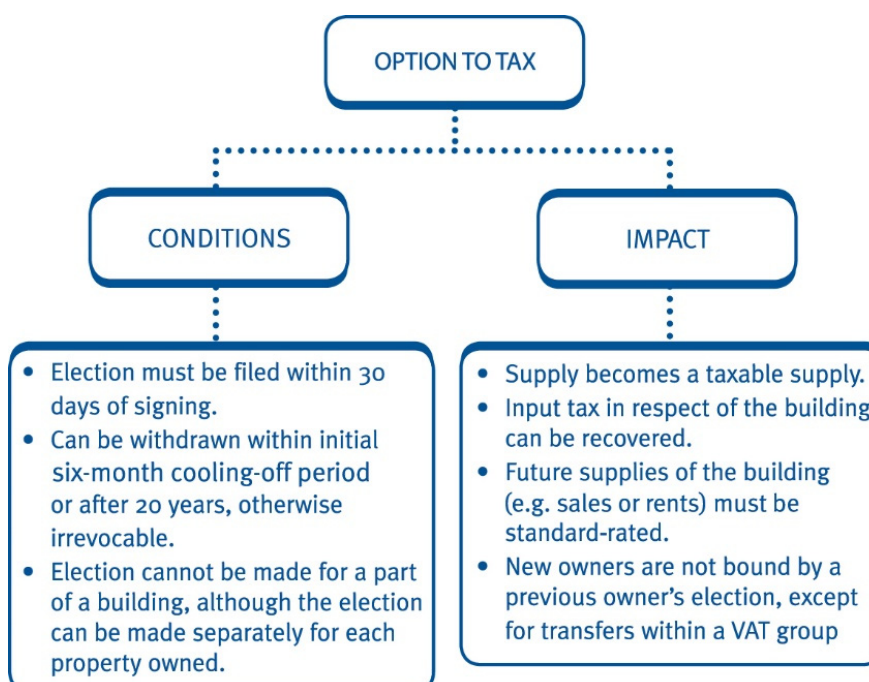
Types of supply

Supplies of land and buildings in the UK can be either be zero-rated, standard-rated or exempt.



Opting to tax

A VAT registered vendor or lessor of a building can opt to waive the exemption of the building. This is usually referred to as 'opting to tax.'



Note that opting to tax is particularly useful for landlords letting out commercial property which would normally be an exempt supply.

- By opting to tax the building, the landlord can recover any input tax on the purchase and running costs of the building.
- Tenants who are fully taxable traders will be able to recover any VAT charged to them on their rents.
- If tenants are exempt or partially exempt traders they will be disadvantaged by the landlord's election, as they will not be able to recover all the VAT charged on their rents. Such traders would prefer to have a tenancy in a building with no option to tax.

Transfer of going concern

Where an option to tax has been made on a building:

- That building can only be included as part of a transfer of a going concern (and therefore avoid VAT) if the new owner also opts to tax the building.
- If the new owner does not make the election, VAT must be charged by the vendor on the sale of the building.

Stamp duty land tax

SDLT is charged on:

- the purchaser of the building
- on the consideration for the building **including VAT** (even if the purchaser can recover the VAT as input tax).



Illustration 2 – VAT on property

State whether the following statements are true or false:

- (1) The waiver of exemption is the same thing as opting to tax.
- (2) Once made, the waiver of exemption can never be revoked.
- (3) If you buy a building which the previous owner has opted to tax, you are obliged to continue the option.
- (4) The sale of second hand commercial buildings is always an exempt supply.
- (5) The supply of new freehold buildings is always a standard-rated supply.

Solution

- (1) True.
- (2) False – the waiver can be withdrawn within an initial six month cooling off period or after 20 years, otherwise it is irrevocable.
- (3) False – the only time this is true is if the sale takes place within a VAT group.
- (4) False – because the owner may have opted to tax the building or it may be less than three years old.
- (5) False – if the building is for residential or charitable use the sale will be zero-rated.

**Test your understanding 3**

- (1) X plc purchases a new factory building for use in its manufacturing trade from a builder, paying £700,000.
- (2) Y plc is granted a 25 year lease on an office block which is intended for use in Y's trade.
- (3) Z plc sells a 15 year old freehold building.

Assume that X, Y and Z plc are all registered traders and all transactions take place within the UK.

State the VAT implications of the above transactions.

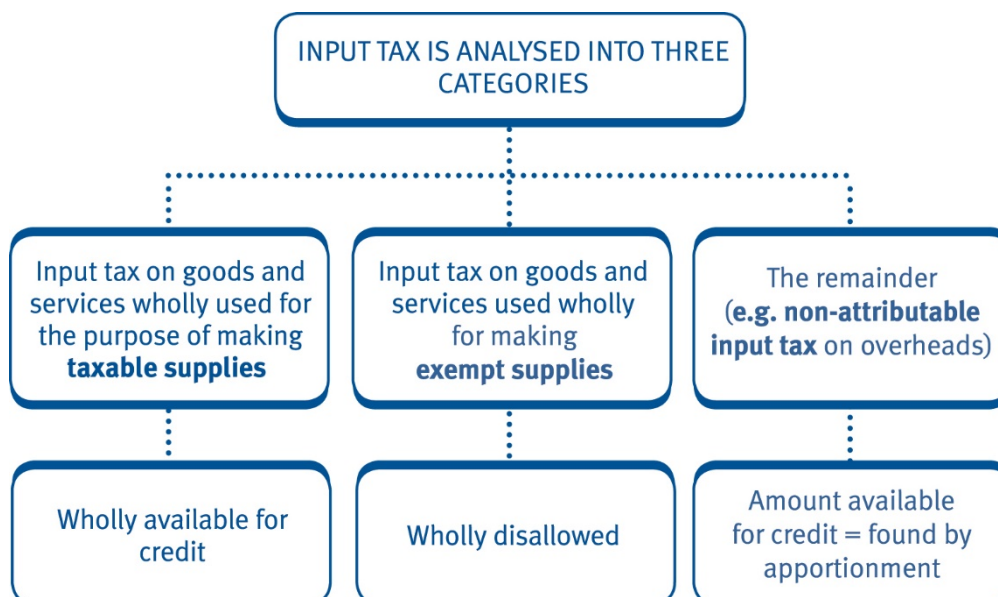
**4 Partial exemption**

Traders who make both taxable and exempt supplies are given credit for only part of the input tax they incur. This section deals with the calculation of the recoverable input tax credit.



Methods of determining recoverable input tax

The standard method for determining the amount of recoverable input VAT is as follows:



- The non-attributable input tax available for credit is the taxable proportion of total supplies (i.e. found by using the fraction):

$$\frac{\text{Total taxable supplies}}{\text{Total supplies}}$$

Exclude VAT and supplies of capital goods when calculating this proportion.

- The ratio is computed as a percentage and, if not a whole number, it is rounded up to the next whole number.
- The percentage used during the year is generally the annual percentage **from the previous year**.

Alternatively, the business can choose to calculate the percentage **each quarter** based on supplies for that quarter.

Whichever method is used, it must be used consistently throughout the year.

In either case, **an annual adjustment** will be made at the end of the accounting period.

- Any other reasonable method of apportionment can be agreed with HMRC.
- Where a VAT group is present the process must be completed using the group figures.

Annual adjustment

The amount of recoverable input VAT is initially calculated for each VAT return period separately (i.e. usually for each quarterly return based on the supplies of the previous year, or the actual supplies for the quarter, or all of it is initially recoverable if the annual test is satisfied).

However, at the end of the accounting period, an annual adjustment calculation must be performed to ensure that the correct amount of input VAT is claimed for the year as a whole.

- Any under or over-declaration is then accounted for to HMRC, or reclaimed from them, on the first VAT return of the next year.
- Alternatively, the business can opt to bring forward the annual adjustment calculation to the last VAT return of the year (for example, if there was a repayment due).

De minimis limits

- All input tax (including that relating wholly or partly to exempt supplies) may be recovered if the business is below the de minimis limits. There are three tests to see whether a business is de minimis:

Simplified test 1	Total input tax \leq £625 per month on average, and value of exempt supplies \leq 50% of value of total supplies
Simplified test 2	Total input tax less input tax directly attributable to taxable supplies \leq £625 per month on average, and value of exempt supplies \leq 50% of value of total supplies
Normal de minimis rule (test 3)	Total irrecoverable input tax (i.e. input tax relating to exempt supplies) \leq £625 per month on average, and \leq 50% of total input VAT

The business only needs to satisfy one test. The simplified tests were introduced to save some businesses the need to carry out a full partial exemption calculation to confirm their de minimis status.

Annual test

- The business can apply the de minimis tests **once a year** rather than every return period if:
 - the business was **de minimis in the previous year**, and
 - the **annual test is applied consistently** throughout the current year, and
 - the **input VAT for the current year is not expected to exceed £1 million**.

- This means that the business can provisionally recover all input VAT relating to exempt supplies in each return period without having to perform de minimis calculations.
- At the end of the accounting period, the de minimis status must be reviewed based on the year as a whole and an annual adjustment made if necessary (see below).



Illustration 3 – Partial exemption

Emina carries on activities which give rise to both taxable supplies and exempt supplies for which input tax is wholly disallowed.

Emina prepares accounts to 31 December each year.

Relevant figures for the quarter ended 30 June 2023 are:

Activity	Attributable input tax £
Standard-rated supplies (£96,000)	10,500
Zero-rated supplies (£32,000)	3,500
Exempt supplies (£37,200)	4,000
	<hr/>
	18,000
Overheads	5,000
	<hr/>
Total input tax	23,000
	<hr/>

Calculate the recoverable input tax for the quarter ended 30 June 2023, assuming Emina chooses to calculate the percentage based on supplies for the quarter.

Solution

De minimis tests

Simplified tests

- (1) Total monthly input tax is £7,667 ($£23,000 \div 3$) on average. As this exceeds £625, simplified test 1 is not satisfied.
- (2) Total input tax less input tax directly attributable to taxable supplies is £9,000 ($£23,000 - £10,500 - £3,500$). This gives a monthly average of £3,000 ($£9,000 \div 3$).

As this exceeds £625, simplified test 2 is not satisfied.

Both simplified tests are failed, therefore the full calculation is required.

Standard de minimis test

Quarter to 30 June 2023	Taxable supplies	Exempt supplies	Total
Input VAT:	£	£	£
Relating to taxable supplies (£10,500 + £3,500)	14,000		14,000
Relating to exempt supplies		4,000	4,000
Relating to overheads (W)	3,900	1,100	5,000
	<u>17,900</u>	<u>5,100</u>	<u>23,000</u>

Monthly input tax relating to exempt supplies is £1,700 (£5,100 ÷ 3) on average.

As this exceeds £625, the normal de minimis test (test 3) is not satisfied.

Recoverable input VAT is therefore £17,900.

Annual adjustment

At the end of the year, when calculating the recoverable input VAT for the quarter ended 31 December 2023, the same calculation needs to be performed on an annual basis.

Any under or over claims for the previous quarters are made in this last return period, or in the first return period of the following year.

Working: Percentage apportionment of input VAT on overheads:

$$\frac{£96,000 + £32,000}{£96,000 + £32,000 + £37,200} \times 100 = 78\% \text{ (Note)}$$

$$£5,000 \times 78\% = £3,900$$

$$£5,000 \times 22\% = £1,100$$

Note: The percentage is rounded up to the nearest whole percentage.



Illustration 4 – Partial exemption annual adjustment

Emina, from Illustration 3, continues to trade for the rest of the year ended 31 December 2023 and reclaims total input VAT of £82,500 over the year.

Her final results for the year are as follows:

Activity	Attributable input VAT £
Standard-rated supplies (£372,000)	39,500
Zero-rated supplies (£131,000)	14,500
Exempt supplies (£151,700)	17,100
	<hr/>
	71,100
Overheads	22,000
	<hr/>
Total input tax	93,100
	<hr/>

Calculate the annual adjustment required for the year ended 31 December 2023.

Solution

De minimis tests

Simplified tests

- (1) Total monthly input tax is £7,758 ($£93,100 \div 12$) on average. As this exceeds £625, simplified test 1 is not satisfied.
- (2) Total input tax less input tax directly attributable to taxable supplies is £39,100 ($£93,100 - £39,500 - £14,500$). This gives a monthly average of £3,258 ($£39,100 \div 12$). As this exceeds £625, simplified test 2 is not satisfied.

Both simplified tests are failed, therefore the full calculation is required.

Standard de minimis test

Year ended 31 December 2023	Taxable supplies	Exempt supplies	Total
Input VAT:	£	£	£
Relating to taxable supplies (£39,500 + £14,500)	54,000		54,000
Relating to exempt supplies		17,100	17,100
Relating to overheads (W)	16,940	5,060	22,000
	<hr/>	<hr/>	<hr/>
	70,940	22,160	93,100
	<hr/>	<hr/>	<hr/>

Monthly input tax relating to exempt supplies is £1,847 (£22,160 ÷ 12) on average.

As this exceeds £625, the normal de minimis test (test 3) is not satisfied.

Recoverable input VAT is therefore £70,940.

Annual adjustment required

	£
Input VAT recoverable for the year	70,940
Less: Input VAT reclaimed	(82,500)
	<hr/>
Amount payable	(11,560)
	<hr/>

As the annual adjustment is an amount payable, it would be beneficial to make this adjustment in the quarter to 31 March 2024 rather than the quarter to 31 December 2023.

Working: Percentage apportionment of input VAT on overheads:

$$\frac{£372,000 + £131,000}{£372,000 + £131,000 + £151,700} \times 100 = 77\% \text{ (Note)}$$

$$£22,000 \times 77\% = £16,940$$

$$£22,000 \times 23\% = £5,060$$

Note: The percentage is rounded up to the nearest whole percentage.



Test your understanding 4

Toby's input tax and supplies made in the quarter to 31 December 2023 are analysed as follows:

	£
Input tax wholly re-taxable supplies	33,250
Input tax wholly re-exempt supplies	4,000
Non-attributable input tax	28,000
Value (excluding VAT) of taxable supplies	250,000
Value of exempt supplies	35,000

- Calculate the deductible input tax assuming that Toby uses the standard method of attribution and chooses to calculate the percentage based on supplies for the quarter.**
- Calculate the annual adjustment assuming the above figures are for the year to 31 December 2023, and the total input VAT recovery based on calculations for the four quarters separately is £53,625.**



Test your understanding 5

Spritz plc owns 100% of the share capital of Enterprise Ltd. Both companies are UK resident trading companies.

All of Spritz plc's supplies for VAT purposes are taxable. Only 25% of the supplies of Enterprise Ltd are taxable and 75% exempt.

Their VAT details for the year ended 31 March 2024 are as follows:

		£
Spritz plc	Total supplies excluding VAT	600,000
	Input tax:	
	Relating to taxable supplies	60,000
	Relating to share of group overheads	5,000
Enterprise Ltd	Total supplies excluding VAT	950,000
	Input tax:	
	Relating to taxable supplies	40,000
	Relating to exempt supplies	115,000
	Relating to share of group overheads	18,000

Explain whether a group VAT registration would be worthwhile.



5 The capital goods scheme

The capital goods scheme applies to partially exempt businesses that spend large sums on land and buildings or computers and computer equipment.

- Where the scheme applies, the initial deduction of input tax is made in the ordinary way and then reviewed over a set adjustment period.
- This is to stop businesses manipulating their proportion of taxable and exempt supplies in the period of purchase in order to reclaim more input tax.

Assets covered by the scheme

The assets dealt with by the scheme are as follows:

Item	Value (VAT-exclusive)	Adjustment period
Land and buildings	£250,000 or more	Ten years (Five years where subject to a lease of less than ten years at acquisition)
Computers and computer equipment	£50,000 or more	Five years

A trader making say 70% taxable supplies and 30% exempt supplies can initially reclaim 70% of the input VAT charged in respect of a building.

Adjustments are made over the next ten (or five) years if the proportion of exempt supplies changes. The year of purchase counts as adjustment year one.

The annual adjustment is:

$$\frac{\text{Total original input tax}}{10 \text{ (or 5) years}} \times (\% \text{ now} - \% \text{ in the original year})$$

The adjustment is made in the second VAT return following the end of the VAT year the adjustment is for.



Illustration 5 – Capital goods scheme

Confusion plc is a company that buys a new freehold building for £5,250,000 including VAT. 40% of the building is used in making exempt supplies and 60% taxable. After seven years this changes to 50%: 50%.

Explain how Confusion plc can recover input VAT on the purchase of the building.

Solution

The purchase of the building is subject to the capital goods scheme as it is a building costing £250,000 or more. The adjustment period is ten years as it is a freehold purchase.

The initial recovery of input tax is:

$$(60\% \times £5,250,000 \times 20/120 \text{ (Note)}) = £525,000$$

For years 1 – 7 of the adjustment period there is no need to make any adjustment.

For each of years 8, 9, 10 the company will have part of its initial input tax recovery clawed back as follows:

$$£875,000 \times 1/10 \times (50\% - 60\%) = £8,750 \text{ owed to HMRC.}$$

Note: The VAT element of £875,000 can be calculated using either 20/120 or 1/6.

**Illustration 6 – Capital goods scheme**

Delta plc is a partially exempt trader and makes 30% exempt and 70% taxable supplies.

On 1 March 2024 Delta plc buys a new freehold building for £2 million including VAT which is used in the same proportion. After two years Delta plc's percentages and use of the building change to 40% exempt and 60% taxable. After a further three years Delta plc ceases the exempt trade and makes only taxable supplies from thereon.

Calculate the input VAT relief that can be obtained by Delta plc.

Solution

The purchase of the building is subject to the capital goods scheme as it is a building costing £250,000 or more. The adjustment period is ten years as it is a freehold purchase.

The initial recovery of VAT is:

$$(70\% \times 20/120 \times £2,000,000) = £233,333.$$

There are no adjustments required for years 1 and 2, but for years 3 – 5 the company must repay part of its input tax relief as follows:

$$£2,000,000 \times 20/120 \times 1/10 \times (60\% - 70\%)$$

$$= £3,333 \text{ due to HMRC for each of the years 3, 4 and 5.}$$

For years 6 – 10 the company will be able to reclaim further input tax relief as follows:

$$£2,000,000 \times 20/120 \times 1/10 \times (100\% - 70\%)$$

$$= £10,000 \text{ due to Delta plc for each of years 6, 7, 8, 9, 10.}$$

Adjustments for sale

On the disposal of an asset under the capital goods scheme during the adjustment period:

- The annual adjustment is made as normal in the year of disposal (as if the asset had been used for the full year).
- A further adjustment must be made to cover the remaining intervals. The adjustment for sale is as follows:
 - If the disposal was taxable (e.g. option to tax exists or the building is less than three years old), we assume 100% taxable use for the remainder of the adjustment period, although note that the VAT recovery cannot exceed the VAT charged on the sale of the asset.
 - If the disposal was exempt (e.g. no option to tax exists), we assume 0% taxable use for the remainder of the adjustment period.

The adjustment for sale is made in the second VAT return following the end of the interval in which the asset is sold.



Illustration 7 – Capital goods scheme

Facts as in Illustration 6, except that Delta plc sells the building in year 6 for £2.5 million.

Calculate the adjustment for year 6 assuming that:

- (a) **Delta plc does not opt to tax the sale**
- (b) **Delta plc opts to tax the sale.**

Solution

- (a) Adjustment for use: Year 6, £10,000 to be reclaimed from HMRC (as above).

Adjustment for sale: As the building is now at least three years old the sale is exempt therefore an amount has to be repaid to HMRC as if the building will have 0% taxable use for the remaining intervals:

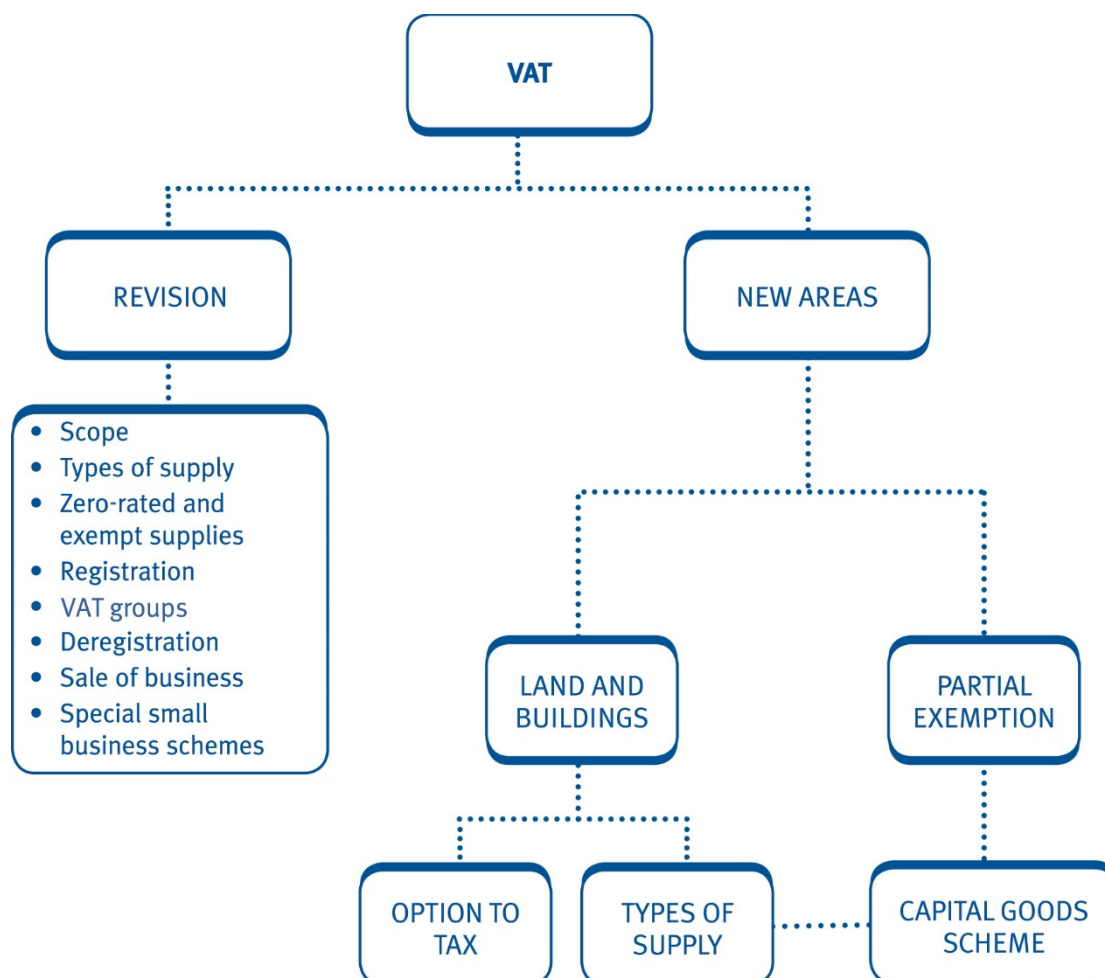
$\text{£2,000,000} \times 20/120 \times 1/10 \times (0\% - 70\%) \times 4 \text{ years} = \text{£93,333}$ repaid to HMRC.

- (b) Adjustment for use: Year 6, £10,000 to be reclaimed from HMRC (as above).

Adjustment for sale: Assume 100% taxable as the option to tax has been exercised:

$\text{£2,000,000} \times 20/120 \times 1/10 \times (100\% - 70\%) \times 4 \text{ years}$
= £40,000 reclaimed from HMRC.

6 Chapter summary



Test your understanding answers



Test your understanding 1

Xioamei**(1) Registration**

- Xioamei will become liable to compulsory registration for VAT when her taxable supplies for any 12 month period exceed £85,000. Her turnover is £9,500 per month starting on 1 January 2023 so she will exceed £85,000 after nine months (i.e. at the end of September 2023).
- She will need to notify HMRC by 30 October 2023 and will be registered with effect from 1 November 2023 or an earlier agreed date.
- As Xioamei is selling to VAT registered traders, there should be no disadvantage to registering for VAT voluntarily before 1 November 2023. Her customers will be able to reclaim any VAT charged by Xioamei.
- The main advantage of registering early is that Xioamei will be able to reclaim input VAT as follows:
 - (i) Computer equipment
 - even if purchased before registration, the VAT can be recovered provided Xioamei still owns the computer at the date of registration. Reclaim £525 ($£3,150 \times 1/6$).
 - (ii) Business telephone
 - reclaim £60 per quarter ($£360 \times 1/6$).
 - (iii) Use of home as office
 - Xioamei can reclaim VAT on the business proportion of her electricity bills £14 ($£71 \times 1/5$) for the year.
 - (iv) Xioamei cannot recover VAT on her car purchase.

She can recover VAT on the running expenses of £183 and VAT on her petrol of £25 per month ($£150 \times 1/6$).

If she recovers input tax on the petrol, she will have to account for a VAT fuel charge due to the private element.

For a car with CO₂ emissions of 140g/km, the VAT scale charge is £331 per quarter, which represents £55 of VAT ($£331 \times 1/6$). This must be added to the output tax for each quarter.

This fuel charge can be avoided if Xioamei does not claim any VAT input tax in respect of fuel.

- (v) If Xioamei registers by 1 June 2023 she will be able to reclaim the input VAT on her accountant's fee for preparing her cash flow projections. This is because she can recover input VAT on services supplied in the six months prior to registration.

(2) Irrecoverable debts

In the quarter which includes October 2024 Xioamei could make a claim for the VAT on her outstanding debt.

The recoverable VAT is £417 ($£2,500 \times 1/6$). This is permitted because Xioamei has written off the debt in her books and it is more than six months since the date payment was due.

(3) Trade discount

Xioamei must charge VAT on the discounted amount. Hence for an invoice for £1,000 excluding VAT, the VAT charged should be:

$$(20\% \times 95\% \times £1,000) = £190$$

(4) Prompt payment discount

Xioamei must charge VAT on the actual amount paid by the customer.

As the customer paid after 21 days, the discount allowed will be 2.5%.

Accordingly, for an invoice of £1,000 excluding VAT, the VAT charged should be:

$$(20\% \times 97.5\% \times £1,000) = £195$$

(5) Sale of business

There are two issues to consider here:

- (i) No VAT needs to be charged if Xioamei sells her business as a going concern provided:
- the new owner is, or is liable to be, VAT registered immediately after the transfer
 - the assets sold are used in the same trade in the future, and
 - there is no significant break in the trading.

Note that all of the above conditions must apply to avoid VAT, otherwise VAT must be charged on the assets that are sold.

- (ii) Xioamei must
- deregister unless her registration is transferred to the new owner. This is unlikely if they are unconnected third parties.
 - notify HMRC that she has ceased to make taxable supplies. This notification must be within 30 days of cessation.
 - account for VAT on the replacement values of her inventory (if any) and tangible non-current assets on hand at the date of deregistration unless the business is sold as a going concern as above. However there will be no charge where the VAT due is below £1,000.



Test your understanding 2

Vector Ltd

(a) VAT Return – Quarter ended 31 March 2024

	£
Output VAT:	
Sales ($£128,000 \times 97.5\% \times 20\%$)	24,960
Advance payment ($£4,500 \times 20/120$)	750
Fuel scale charge ($£276 \times 20/120$)	46
	<hr/> 25,756
Input VAT:	
Expenses ($£74,800 - £4,200 \times 20\%$)	(14,120)
Irrecoverable debt relief ($£4,000 + £4,000 \times 20\%$)	(1,600)
	<hr/> 10,036
VAT payable	<hr/>

Notes:

- (1) The calculation of output VAT on sales must take into account the trade discount. VAT is therefore calculated on 97.5% of the sales value.
- (2) Input VAT on business entertainment is not recoverable, unless it relates to entertaining overseas customers.
- (3) Relief for an irrecoverable debt is not given until six months from the time that payment is due. Therefore, relief can only be claimed in respect of the invoices due for payment on 15 August and 15 September 2023.

- (4) Input VAT cannot be recovered in respect of the car as it is not used exclusively for business purposes.

Note: Although the ACCA uses a VAT fraction of 20/120 it is equally valid to use a VAT fraction of 1/6.

Amounts due from customers are normally recorded inclusive of VAT. However, the question clearly states that all figures are VAT-exclusive unless stated otherwise. Hence the two invoices of £4,000 due from a customer and written off as irrecoverable debts are treated as VAT-exclusive.

(b) **Cash accounting scheme**

- Vector Ltd can use the cash accounting scheme if its expected taxable turnover (excluding VAT and sales of capital assets) for the next 12 months does not exceed £1,350,000.
- In addition, the company must be up-to-date with its VAT returns and VAT payments.
- The scheme will result in the tax point becoming the date that payment is received from customers.
- This will provide for automatic irrecoverable debt relief should a customer not pay.
- However, the recovery of input VAT on expenses will be delayed until payment is made.



Test your understanding 3

VAT on property

(1) **X plc**

The builder will charge VAT on the sale of a new commercial building. As it says that X plc paid £700,000 it can be assumed that this is the VAT-inclusive price.

The VAT of £116,667 ($20/120 \times £700,000$) can be reclaimed by X plc as they plan to use the building to make taxable supplies.

(2) **Y plc**

Unless the landlord has opted to tax the transaction, this will be an exempt supply. Y plc will not incur any input tax.

(3) **Z plc**

Normally the sale of a building at least three years old will be an exempt supply and no VAT will be charged. However, if Z plc has opted to tax the building then they will have to charge VAT on the disposal.



Test your understanding 4

(a) Toby – Quarter ended 31 December 2023

	Taxable supplies	Exempt supplies	Total
Input VAT:	£	£	£
Relating to taxable supplies	33,250		33,250
Relating to exempt supplies		4,000	4,000
Relating to overheads (W)	24,640	3,360	28,000
	<hr/> 57,890	<hr/> 7,360	<hr/> 65,250

De minimis test

The total input VAT, total input VAT less input VAT directly attributable to taxable supplies, and total irrecoverable input VAT (i.e. input VAT relating to exempt supplies), are all clearly greater than £625 per month on average for the three month period, therefore none of the de minimis tests are satisfied.

The recoverable input VAT is therefore £57,890.

Working: Allocate non-attributable VAT

Taxable % apportionment

$$= \frac{£250,000}{£250,000 + £35,000} \times 100 = 88\% \text{ (round up to whole \%)}$$

$$£28,000 \times 88\% = £24,640$$

$$£28,000 \times 12\% = £3,360$$

(b) Annual adjustment

If the above figures are annual figures, the apportionment would be the same but the de minimis tests need to be reconsidered:

- Total monthly input tax is £5,437 (£65,250 ÷ 12) on average.
As this exceeds £625, test 1 is not satisfied.
- Total input tax less input tax directly attributable to taxable supplies is £32,000 (£65,250 – £33,250). This gives a monthly average of £2,667 (£32,000 ÷ 12).
As this exceeds £625, test 2 is not satisfied.
- Monthly input tax relating to exempt supplies is £613 (£7,360 ÷ 12) on average. This is less than £625. The total irrecoverable VAT (i.e. input tax relating to exempt supplies) of £7,360 is also less than £32,625 (50% of total input VAT of £65,250).
Test 3 is therefore satisfied.

Accordingly, all input VAT suffered for the year of £65,250 can be recovered.

The annual adjustment is therefore £11,625 (£65,250 – £53,625).

As this is a repayment of input VAT, Toby will claim to make the adjustment in the last quarter return to 31 December 2023 rather than wait until the first quarter of the following year.



Test your understanding 5

Spritz plc

Without a group registration:

Both companies account for VAT separately and the input tax recovery would be as follows:

	£
Spritz plc (can recover all input VAT)	65,000
Enterprise Ltd (W1)	44,500
	<hr/>
Recoverable input VAT	109,500
	<hr/>

With a group VAT registration:

Spritz plc and Enterprise Ltd (W2)

– Relating to taxable supplies	100,000
– Relating to group overheads	12,650
	<hr/>
	112,650
	<hr/>

Conclusion

It is worthwhile for Spritz plc and Enterprise Ltd to form a VAT group as it allows a higher recovery of input VAT of £3,150 (£112,650 – £109,500).

Working**(W1) Enterprise Ltd**

	Total	Taxable supplies	Exempt supplies
	£	£	£
Relating to taxable supplies	40,000	40,000	
Relating to exempt supplies	115,000		115,000
Relating to overheads (25%/75%)	18,000	4,500	13,500
	<hr/>	<hr/>	<hr/>
	173,000	44,500	128,500
	<hr/>	<hr/>	<hr/>

De minimis test

The total input VAT, total input VAT less input VAT directly attributable to taxable supplies, and input VAT relating to exempt supplies, are all clearly greater than £625 per month on average, therefore none of the de minimis tests are satisfied.

(W2) Group position

	Total	Taxable supplies	Exempt supplies
	£	£	£
Relating to taxable supplies (£60,000 + £40,000)	100,000	100,000	
Relating to exempt supplies	115,000		115,000
Relating to overheads (£5,000 + £18,000) (see below for split) (55%/45%)	23,000	12,650	10,350
	<hr/>	<hr/>	<hr/>
	238,000	112,650	125,350
	<hr/>	<hr/>	<hr/>

Split of non-attributable VAT

Taxable supplies = £600,000 + (25% × £950,000) = £837,500

Total supplies = (£600,000 + £950,000) = £1,550,000

Taxable % apportionment:

$(£837,500 \div £1,550,000) \times 100 = 55\%$ (rounded up to whole %)

De minimis test

The total input VAT, total input VAT less input VAT directly attributable to taxable supplies, and input VAT relating to exempt supplies, are all clearly greater than £625 per month on average, therefore none of the de minimis tests are satisfied.

VAT: Administration and overseas aspects

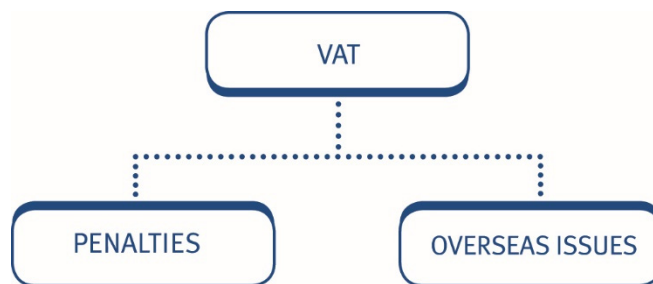
Chapter learning objectives

Upon completion of this chapter you will be able to:

- understand the statutory obligations imposed in a given situation, including any time limits for action and advising on the implications of non-compliance
- advise on the VAT implications of imports and exports



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities in accordance with legal requirements. Another performance objective (PO16) is to make sure individuals and entities comply with their tax obligations – on time, and in the spirit and letter of the law. Working through this chapter should help you understand how to demonstrate these objectives.



Introduction



This chapter revises the rules for penalties and interest covered at TX. The chapter also covers the main new topic at ATX, namely some overseas aspects of VAT.

1 Electronic filing of VAT returns

All businesses must file the VAT return online and pay the VAT electronically:

- within **one month and seven days** of the end of the return period.

Following the introduction of Making Tax Digital, businesses submit their VAT return to HMRC via specialist software.

The details of Making Tax Digital are not examinable in the ATX exam.



Substantial traders

Substantial traders are those with a VAT liability exceeding £2.3 million p.a.

- Monthly payments on account are required.
- Payments at the end of months 2 and 3 in every quarter are 1/24th of the annual liability for the previous year.
- Any additional amounts are paid with the normal VAT return.

Other methods can be agreed with HMRC for calculating the payments on account.

A trader can leave the scheme if its latest annual VAT liability is less than £1.8 million.

2 Penalties for late filing and late payment



The rules for VAT penalties were covered at TX. However, a new penalty system was introduced in 2023 to replace the previous default surcharge rules. There are now separate penalties for late filing of VAT returns and late payment of VAT. A brief overview of the rules is given below and is summarised in the diagram in section 4.

Penalties for late filing of VAT returns

A points-based system applies for late submission of VAT returns.

- Each time a quarterly VAT return is submitted late, the taxpayer receives one penalty point.
- Once the taxpayer reaches the threshold of **four penalty points**, a **£200 penalty** is charged.
- Every subsequent late VAT return will also incur a £200 penalty, but the points total will not increase further.
- While the taxpayer is below the penalty points threshold, each penalty point expires after two years.
- However, once the threshold has been reached, penalty points do not expire. Instead, the taxpayer must submit all VAT returns on time for a 12-month period (i.e. four quarterly returns) to reset the points to zero.



There are different points thresholds for annual and monthly returns, but these are not examinable.

Penalties for late payment of VAT

If VAT is paid late, HMRC may impose a late payment penalty.

Penalties are calculated as follows:

Days late	Penalty (% of VAT due)
Up to 15 days	None
16 to 30 days	2%
More than 30 days	4% plus 4% daily penalty



The above information on late payment penalties will be given in the tax tables provided in the exam.

The penalties for late submission and late payment may be cancelled if the taxpayer has a reasonable excuse.



Illustration 1 – Penalties for late filing and late payment

Mark's VAT return for the quarter ended 30 June 2023 was submitted late, and the VAT due of £14,500 was not paid until 16 August 2023.

His return for the following quarter to 30 September 2023 was also submitted late and the VAT due of £16,200 was not paid until 28 November 2023.

Mark had previously received two penalty points for late submission of VAT returns in the past year.

Explain the late filing and late payment penalties incurred by Mark.

Solution

(1) VAT return period ended 30 June 2023

One penalty point is incurred for late submission, making three cumulatively.

Payment was due on 7 August 2023, so it was less than 15 days late and therefore no late payment penalty is due.

(2) VAT return period ended 30 September 2023

One penalty point is incurred for late submission, making four cumulatively, so a late payment penalty of £200 will be charged.

Mark must now submit four VAT returns on time to reset penalty points to zero.

Payment was due on 7 November 2023, so was between 16 to 30 days late. A penalty of £324 ($£16,200 \times 2\%$) is due.

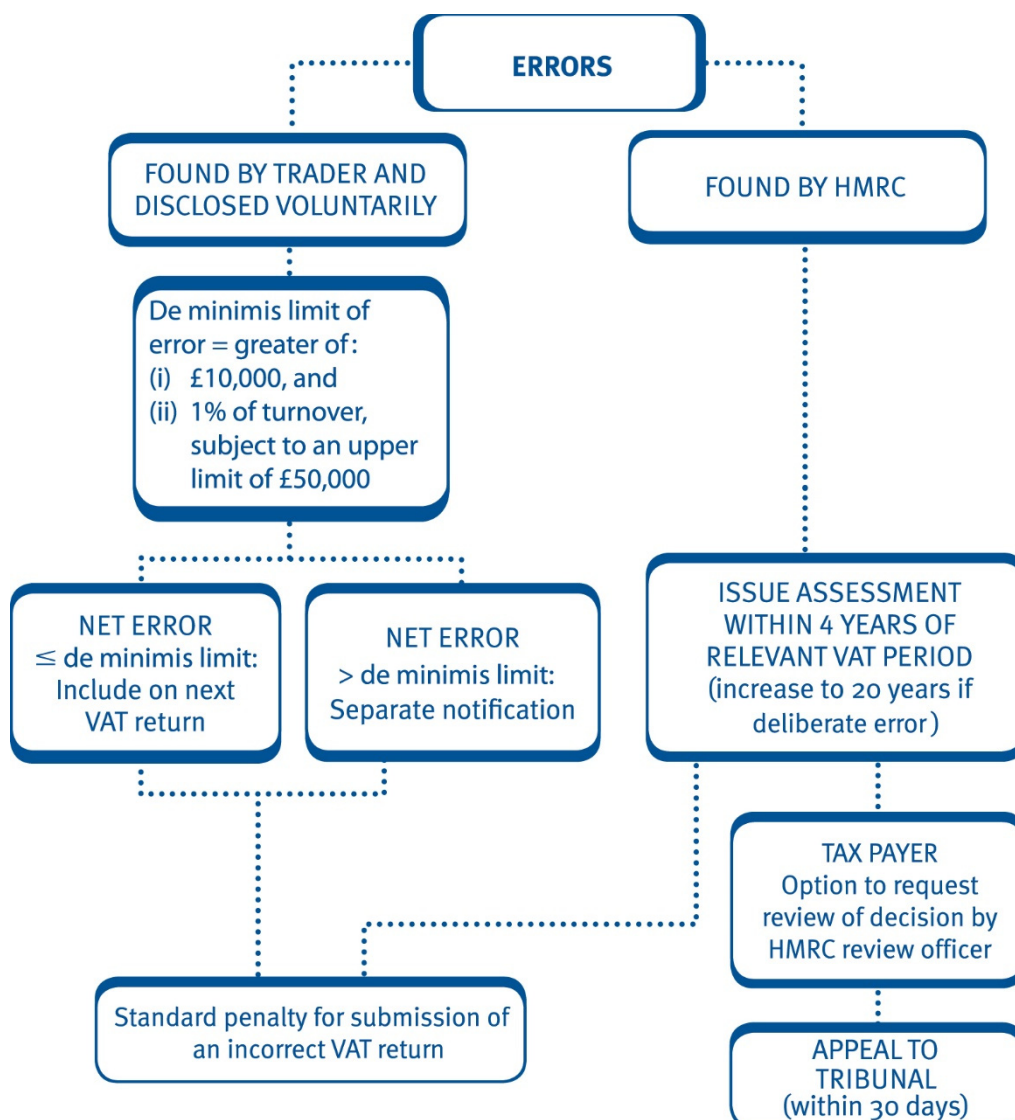
3 Errors on a VAT return

VAT is a self-assessed tax. Traders calculate their own liabilities or repayments.

- HMRC makes occasional control visits to check that returns are correct.
- HMRC has the power to enter business premises, inspect documents, including statements of profit or loss and statements of financial position, take samples, and inspect computer records (see Chapter 15 for HMRC information and inspection powers).

Errors on earlier VAT returns

If a trader realises that there is an error this may lead to a standard penalty as there has been a submission of an incorrect VAT return (see Chapter 15).



4 Late payment interest

As for other taxes, interest will be charged if **any** VAT is paid late.

Interest is charged on a daily basis

- from: the due date
- to: the date of payment.
- at a rate of 6.5% p.a. (rate given in tax rates and allowances).

However, in the examination, if required, calculations should be performed to the nearest month and £ unless indicated otherwise in the question



Illustration 2 – Penalties and interest

Hopeless Ltd has recently had a control visit from HMRC. During the visit it has been discovered that on its previous VAT return for the quarter to 31 March 2024, Hopeless Ltd forgot to include output VAT on £500,000 (VAT-exclusive) of taxable supplies.

The actual output and input tax included in the return were as follows.

	£
Output tax	100,000
Input tax	30,000
	<hr/>
Due to HMRC	70,000
	<hr/>

Hopeless paid the underpaid VAT on 6 June 2024.

State whether a penalty for submission of an incorrect return will be levied on Hopeless Ltd and, if so, discuss the maximum penalty that will be imposed.

State the position with respect to interest.

Solution

The error Hopeless Ltd has made is to under declare output VAT of:

$$(20\% \times £500,000) = £100,000.$$

This means the VAT return for the quarter to 31 March 2024 is incorrect due to an understatement of the VAT liability.

The standard penalty therefore applies and is determined according to:

- The amount of tax understated.
- The reason for the understatement.
- The extent of disclosure by the taxpayer.

The level of the penalty is a percentage of the revenue lost as a result of the inaccuracy or under assessment and depends on the behaviour of the taxpayer as follows:

Taxpayer behaviour	Maximum penalty	Minimum penalty – unprompted disclosure	Minimum penalty – prompted disclosure
Deliberate and concealed	100%	30%	50%
Deliberate but not concealed	70%	20%	35%
Careless	30%	0%	15%



The above table is provided in the tax rates and allowances in the examination.

The penalties may be reduced as shown in the table above, depending on the type of penalty and whether the taxpayer makes an unprompted disclosure of the understatement.

There is no penalty for incorrect returns where a genuine mistake has been made.

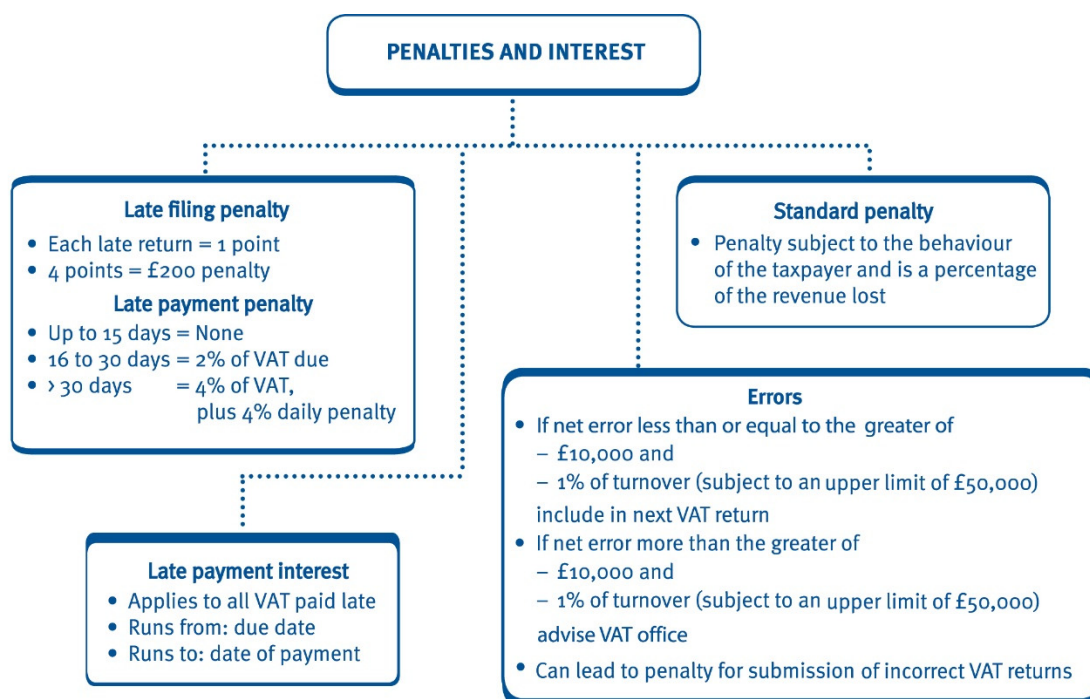
As Hopeless Ltd has not voluntarily disclosed the error (as it was discovered by HMRC), no reduction is likely to be made for unprompted disclosure.

Where the return is incorrect through deliberate intention of a third party, the penalty can be charged on the third party.

Interest will also be charged from the date the VAT should have been paid (7 May) until the date of payment on 6 June but is calculated to the nearest month here.

The charge will be: $(1/12 \times 6.5\% \times £100,000) = £542$

Summary



5 Overseas aspects of VAT

Imports of goods

A postponed VAT accounting system generally applies, where a VAT registered business accounts for the VAT on goods purchased from **any** overseas country on its VAT return.

The purchaser accounts for output VAT at the relevant rate (sometimes known as import VAT) and can then reclaim this as input VAT, subject to the normal rules.

If all of the input VAT is recoverable then the effect will be tax neutral since the output and input VAT will cancel each other out on the return.

The import VAT is accounted for on the VAT return which covers the date the goods were imported.

Traders who are not VAT registered, such as exempt traders, will still have to pay import VAT, but will not be able to reclaim it.

Postponed accounting is optional, and there are some situations where it cannot be used. For the purposes of the exam it is assumed that postponed accounting applies to all imports.

There are different rules in place for imports of goods with a value of less than £135, but these are not examinable.

Exports of goods

The export of goods outside the UK is a zero-rated supply.

Zero-rating is a favourable treatment for the exporter as it allows them to recover input tax. It also means the customer is not charged VAT.



Test your understanding 1

Foreign Ltd, a UK resident company registered for VAT, has the following international transactions.

- (a) Sale of children's toys to a customer in Germany, who is VAT registered.
- (b) Purchase of silk fabric from Hong Kong.

Outline the VAT treatment in each case for Foreign Ltd.

Supply of services

The rules governing VAT on the supply of services are complex. These notes just cover the basic principles needed for the ATX examination.

For services, VAT is generally charged at the place of supply.



The place of supply varies depending on whether the customer is a business or non-business customer.

Supply of service to	Place of supply
Business customer (B2B)	Where the customer is established
Non-business customer (B2C)	Where the supplier is established

These rules can be applied to a UK business as follows:

UK business		Accounting for VAT
Supplies services to	Overseas business customer (B2B)	<ul style="list-style-type: none"> Place of supply is overseas Outside the scope of UK VAT
	Overseas non-business customer (B2C)	<ul style="list-style-type: none"> Place of supply is UK. Output VAT charged at standard UK rate
Receives services from	Overseas business (B2B)	<ul style="list-style-type: none"> Place of supply is UK Reverse charge procedure: <ul style="list-style-type: none"> UK business accounts for 'output VAT' at standard UK rate on VAT return. This VAT can then be reclaimed as input VAT

Time of supply for cross border supplies of services

The rules are governed primarily by when a service is performed and a distinction is made between single and continuous supplies.

- For single supplies, the tax point will occur on the **earlier of**:
 - when the service is completed, or
 - when it is paid for.
- In the case of continuous supplies, the tax point will be the end of each billing or payment period.



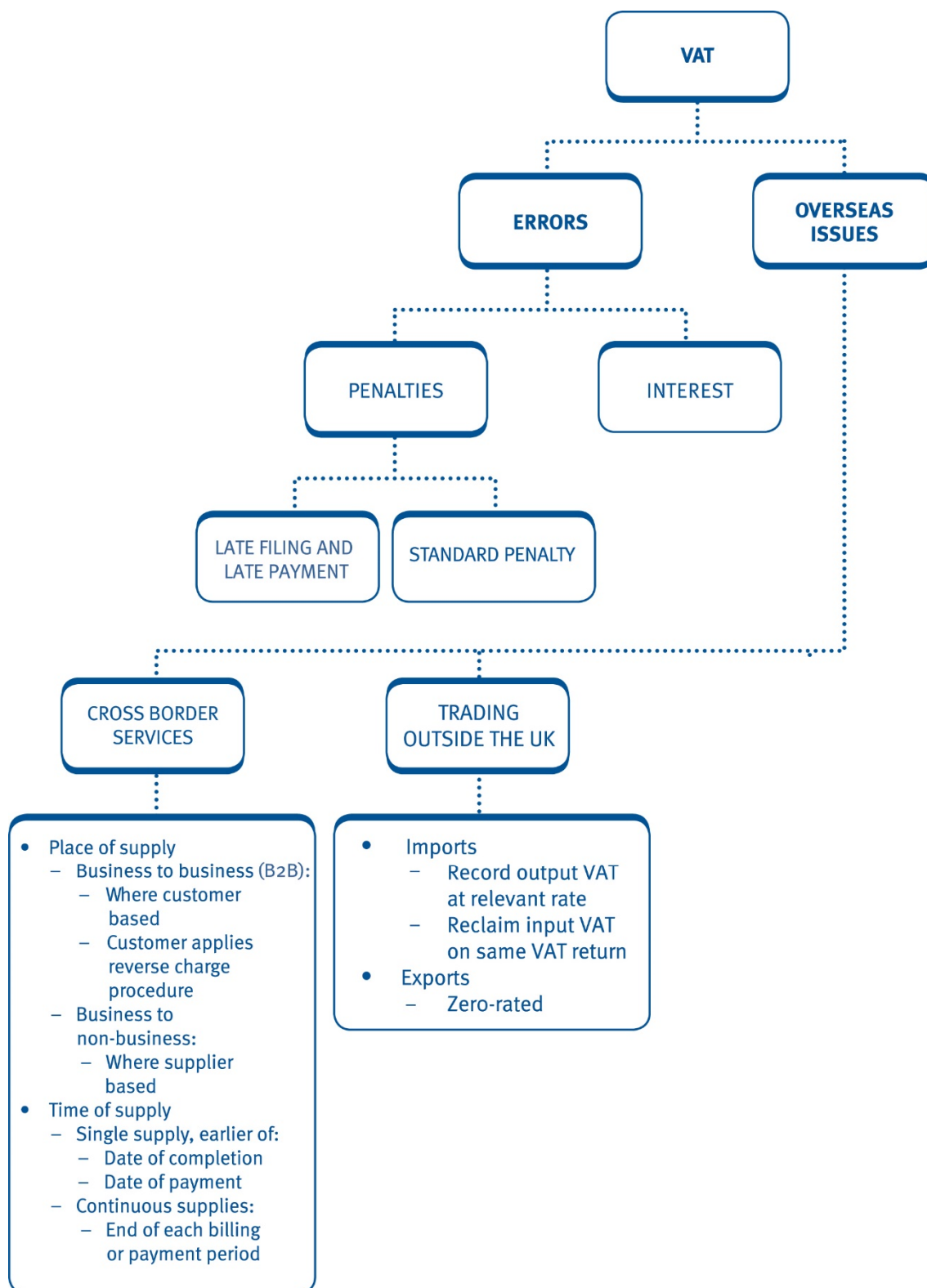
Test your understanding 2

Ginger Ltd, a UK resident trading company registered for VAT, has the following international transactions.

- (a) Provision of consultancy services to Greta who is resident in Germany.
- (b) Provision of consultancy services to Blonde Inc which is a company resident in the USA.
- (c) Ginger Ltd purchased accountancy services from Auburn LLP, an accountancy firm registered in France.

Outline the VAT treatment in each case for Ginger Ltd.

6 Chapter summary



Test your understanding answers



Test your understanding 1

Foreign Ltd

- (a) Foreign Ltd will charge VAT at the zero rate because it is an export outside the UK.
- (b) Foreign Ltd will account for output VAT on its VAT return and then recover this as input VAT on the same return.



Test your understanding 2

Ginger Ltd

- (a) This is a business to consumer transaction and so the supply is deemed to take place where the supplier (Ginger Ltd) belongs. Ginger Ltd will charge output VAT as normal on the provision of services.
- (b) The supply of services to Blonde Inc is a business to business transaction. As such, the supply is deemed to take place where the customer (Blonde Inc) belongs. The place of supply is therefore the USA and so the transaction is outside the scope of VAT for Ginger Ltd.
- (c) Ginger Ltd has purchased services from another business, therefore this is a business to business transaction. The supply is deemed to take place where the customer (Ginger Ltd) belongs. As the supply is deemed to take place in the UK Ginger Ltd must record output VAT at the standard rate on its return, which can then be reclaimed as input VAT.

Professional skills

Chapter learning objectives

This chapter contains an overview of the professional skills syllabus area. This is relevant for all ACCA Strategic Professional Options Exams (AFM, APM, AAA and ATX-UK).

1 Purpose of chapter

This chapter explains the content included within the professional skills syllabus area. This syllabus section is included in all Strategic Professional Options Exams syllabi.

The inclusion of this syllabus area reflects ACCA's continued focus on ensuring that the professional accountants of the future have the right blend of technical and professional skills, coupled with an ethical mindset. These professional skills will make candidates more employable, or if already in work, will enhance their opportunities for advancement.

More details can also be found in the professional skills section on the ACCA website.

2 Content of the professional skills syllabus area

The Strategic Professional Options Exams will expect candidates to demonstrate the following Professional Skills:

- Communication
- Analysis and Evaluation*
- Scepticism (and Judgement)**
- Commercial Acumen

*Analysis and Evaluation have been combined into one overall skill, as it has been deemed that for the Options exams, analysis is done in order to arrive at a thorough and comprehensive evaluation of a matter.

** Judgement is added to the Scepticism descriptor for Advanced Audit and Assurance (AAA) only, as it is a defined requirement for auditors.

Each of the four professional skills has a number of leadership capabilities associated with it. The Strategic Professional Options Exams will use these capabilities to allocate marks in each exam question as appropriate.

More detail on the capabilities associated with these professional skills are given in section 4 below.

3 Format of the ATX exam, including professional skills

	Total marks	Technical marks	Professional skills marks
Section A: One compulsory question	50	40	10
Section B: Two compulsory questions	50 (25 per question)	40 (20 per question)	10 (5 per question)
Overall	100	80	20

- The syllabus is assessed by a 3 hour 15 minutes computer based examination (CBE).
- The pass mark for all ACCA Qualification examinations is 50%.
- The technical syllabus sections are A, B, and C.
- Syllabus section D is professional skills:
 - In terms of earning professional skills marks, the examining team will be looking for that skill to be evident in the technical points you make.
 - The professional skills marks will be attached to the overall question, rather than individual requirements.
- For both technical and professional skills marks there will be slightly more marks available than the set amount for students to score, for example in a Section B question there are five professional skills marks, however those five marks could be scored from a possible seven marks.
- Syllabus section E is employability and technology skills (discussed in Chapter 29).

Section A

Section A will always be a single 50-mark case study. The 50 marks will comprise of 40 technical marks and 10 professional skills marks.

All four of the professional skills will be examined in Section A. The professional skill “Communication” will only appear in the Section A question, because that is where a request for a specific format for the answer (i.e. a report format) will be made.

Section A may contain more than one client, and therefore more than one output may be required (e.g. a report and paragraphs to include in a letter).

Section B

Section B will consist of two compulsory 25-mark questions. The 25 marks in each question will comprise of 20 technical marks and 5 professional skills marks.

Section B questions will contain a combination of professional skills appropriate to the question and the marks will not necessarily be an even split across the skills being tested. Each question will contain a minimum of two professional skills from Analysis and Evaluation, Scepticism and Commercial Acumen.

Question presentation

The wording for the Professional Skills at the end the Section A question will be:

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation, scepticism and commercial acumen in your answer. (10 marks)

For Section B questions, only the Professional Skills being tested in that question will appear, so for example:

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer. (5 marks)

4 Details of the professional skills for ATX

In the ACCA's detailed ATX study guide, the professional skills are fully explained. This explanation is included and built upon below.

Communication



Detailed study guide explanation of "Communication"

Leadership capability	Explanation
Inform	Inform concisely, objectively and unambiguously, adopting a suitable style and format, using appropriate technology.
Persuade	Advise using compelling and logical arguments, demonstrating the ability to counter argue where appropriate.
Clarify and simplify	Clarify and simplify complex issues to convey relevant information in a way that adopts an appropriate tone and is easily understood by and reflects the requirements of the intended audience.

In summary, this means you have to express yourself clearly and convincingly through the appropriate medium while being sensitive to the needs of the intended audience. This means responding in a professional manner and adhering to any specific instructions made.



Illustration 1 – Communication skills marks in ATX

In the ATX exam, some examples of how communication skills marks could be awarded in Section A are as follows:

- Producing an answer in the **correct format**. You will be asked to give your answer in a specific format and this should be evident in your response, whether this is more formal (such as a report to a client) or a more flexible (such as notes for a colleague).
- Appropriate **style, presentation and tone** – Your response should be organised, and easy to follow, adopting a professional tone. Using headings helps the recipient of the document (i.e. the marker) to see that you have addressed all parts of the requirements (and helps you to do this). Part of good presentation is the appropriate choice of either the spreadsheet or word processing tool. If both are used together, there should be clear flow between the two.
- **Effectiveness and clarity of communication** – Both the written parts of your response and calculations need to be clear. Answers must be relevant and specific. You should not answer in general terms or by listing everything you know about a topic.
- **Adherence to a specific request** – Your response should be relevant to what is being asked and should follow the instructions given. For example, if asked to recommend steps to take in an ethical scenario, you should give clear actions.

Analysis and Evaluation



Detailed study guide explanation of “Analysis and Evaluation”

Leadership capability	Explanation
Investigate	Investigate relevant information from a range of sources, using appropriate analytical techniques to establish reasons and causes of issues, assist in decision-making and to identify opportunities or solutions.
Consider	Consider information, evidence and findings carefully, reflecting on their implications and how they can be used to best support the interests of the individual, entity or wider business organisation.
Assess and apply	Assess and apply appropriate judgement when considering ethical, professional or other technical issues; when making conclusions or recommendations, taking into account the implications of such decisions on the entity or individual affected.

Appraise	<p>Appraise information objectively in order to effectively prioritise issues; identifying missing information and exploring suitable alternatives when making decisions, devising courses of action or providing conclusions or recommendations.</p> <p>Communicate conclusions reached, together, where necessary with relevant supporting computations</p>
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In summary, this means you firstly have to thoroughly investigate and research information from a variety of sources and logically process it with a view to prioritising activities and arriving at an appropriate conclusion or recommendation (“Analysis”).

This analysis should form part of a comprehensive evaluation of a matter where you have to carefully assess situations, proposals and arguments in a balanced and cogent way, using professional and ethical judgement to predict future outcomes and consequences as a basis for sound decision-making (“Evaluation”).



Illustration 2 – Analysis and evaluation skills marks in ATX

In the ATX exam, some examples of how analysis and evaluation skills marks could be awarded are as follows:

- **Application of tax knowledge to the scenario.** You may need to analyse the tax consequences of alternative proposals and then evaluate which is the better course of action. Your recommendation needs to be relevant to, and clearly reference, the particular facts of the scenario.
- **Identify and explore variables.** The scenario information may include variables or uncertainties, for example, different dates for a transaction. Your response should analyse the differences between them, identifying any beneficial tax treatments of one over another. For example, a company proposing the sale of shares on two possible dates may benefit from the substantial shareholding exemption if the later date is chosen.
- **Balanced appraisal and reasoned judgement.** You may need to determine the priorities for a particular scenario. For example, you might work out that loss relief could save tax at a higher rate if the loss is carried forward. However, if cash flows are a problem for that taxpayer, a recommendation of a claim for relief as soon as possible would be appropriate.

Scepticism



Detailed study guide explanation of “Scepticism”

Leadership capability	Explanation
Explore	Explore the underlying reasons for issues, applying an attitude of a questioning mind where appropriate, beyond what is immediately apparent.
Question	Question opinions, assertions and assumptions, by seeking justifications and obtaining sufficient evidence for either their support and acceptance, or rejection.
Challenge and critically assess	Challenge and critically assess the information presented or decisions or recommendations made, where this is clearly justified, in the wider professional, ethical, organisational or public interest. State and explain assumptions made or limitations in the analysis provided; together with any inadequacies in the information available and/or additional information required to provide a fuller analysis.

In summary, this means you have to explore, question and challenge information and views presented to you, identifying if all information is available or whether there may be underlying bias, to fully understand business issues and establish facts objectively, based on ethical and professional values.

You will not be expected to question every fact, assertion or number provided in a scenario. Most information can be taken at face value unless there is a clear indication that the information source is unreliable, or otherwise questionable.



Illustration 3 – Scepticism skills marks in ATX

In the ATX exam, some examples of how scepticism skills marks could be awarded are as follows:

- **Identification of insufficient information.** You should explain and indicate how your recommendation would vary depending on that information. For example, you may need more information to determine whether all the conditions for a particular relief have been met.
- **Challenging views and opinions.** For example, a client may have heard about actions taken by others to save tax and express a wish to do the same. If these actions would not work as the client thinks, you should explain why and justify your response. The question would make clear if you are required to challenge an opinion or comment in this way.

Commercial Acumen



Detailed study guide explanation of “Commercial Acumen”

Leadership capability	Explanation
Demonstrate awareness	Demonstrate awareness of organisational and external and other non-tax factors which will affect decisions with regard to tax taken by an individual or entity.
Recognise key issues and use judgement	Recognise key issues in a given scenario and use judgement in proposing and recommending commercially viable solutions. Offer solutions which are practical and commercial in the context of the scenario being considered.
Show insight	Show insight and perception in understanding key tax drivers of an individual or entity, demonstrating acumen in arriving at appropriate recommendations.

In summary, this means you have to show awareness of the wider business environment and external factors affecting business and use commercially sound judgement and insight to resolve issues, exploit opportunities and offer valid advice and realistic recommendations.



Illustration 4 – Commercial acumen skills marks in ATX

In the ATX exam, some examples of how commercial acumen skills marks could be awarded are as follows:

- **Recommendations are practical, plausible and relevant** for that particular entity. Advice will obviously vary depending on the circumstances and nature of the taxpayer, with that appropriate for a sole trader, for example, being different to that for a large corporate group.
- **Solutions are realistic and commercial**, recognising practical, non-tax factors and internal constraints. For example, clients may be advised to save inheritance tax by giving away assets during their lifetimes, but they still need to retain some, such as a house to live in, and cash or income-producing assets to pay their expenses.
- **Recognition of the impacts of past and future actions.** This may include realising that the time limit for a claim has not yet expired and so recommending the claim, even if it is some time since the transaction took place.

- **Awareness of the reasons for certain tax legislation.** For example, gift holdover relief is usually only available on a gift to a UK resident, as otherwise the asset (and so the held over gain) would leave the charge to UK tax.
- **Awareness of the wider consequences of a proposal.** For example, an individual who is non-UK domiciled may elect to be treated as UK domiciled. This would allow for receipt of unlimited gifts, exempt from inheritance tax, from a UK domiciled spouse or civil partner. However, the individual's overseas assets would then come within the charge to UK inheritance tax in future.

5 General advice from the ACCA examining team

- Make sure you include the most important, relevant, and crucial points relating to the requirement. Use your judgment to consider which points are the most convincing and compelling and only include additional less important points if you are not sure you have made enough valid points to achieve all the technical marks available for the requirement.
- Show deep/clear understanding of underlying or causal issues and integrate or link information from various parts of the scenario or different exhibits.
- Only make relevant points and try not to include superfluous information or make unsupported points. Bland statements with no application do not demonstrate professionalism nor does including information which does not address the requirements.
- Avoid repeating points already made. Professionally competent candidates do not needlessly repeat information. They may reinforce a previous point, but this is usually made as a development of a point rather than repetition.
- Address the requirements as written, taking particular notice of the verb used. Answering the question asked is an indication of your ability to read and comprehend instructions appropriately as is a demonstration of professionalism expected in the workplace.
- Show your ability to prioritise and make points in a logical and progressive way, building your response to a question.
- Structure and present your answers in a professional manner through faithfully simulating the task as would be expected of a professional accountant.
- Demonstrate evidence of your knowledge from previous learning or wider reading and apply this knowledge appropriately to strengthen arguments and make points more convincing.
- Demonstrating professionalism is not about linguistic eloquence or having an extensive vocabulary or having perfect grammar, it is about the ability to express points clearly, factually, and concisely and show credibility in what you are saying.

6 Time management and planning

For time management purposes, candidates should allocate time based on the technical marks available, as the professional skills marks should not be thought of as separate requirements. Remember professional skills marks are earned as you work through the technical marks by providing comprehensive and relevant responses to the technical requirements.

In terms of time management, it is important to use the approach that will suit you best:

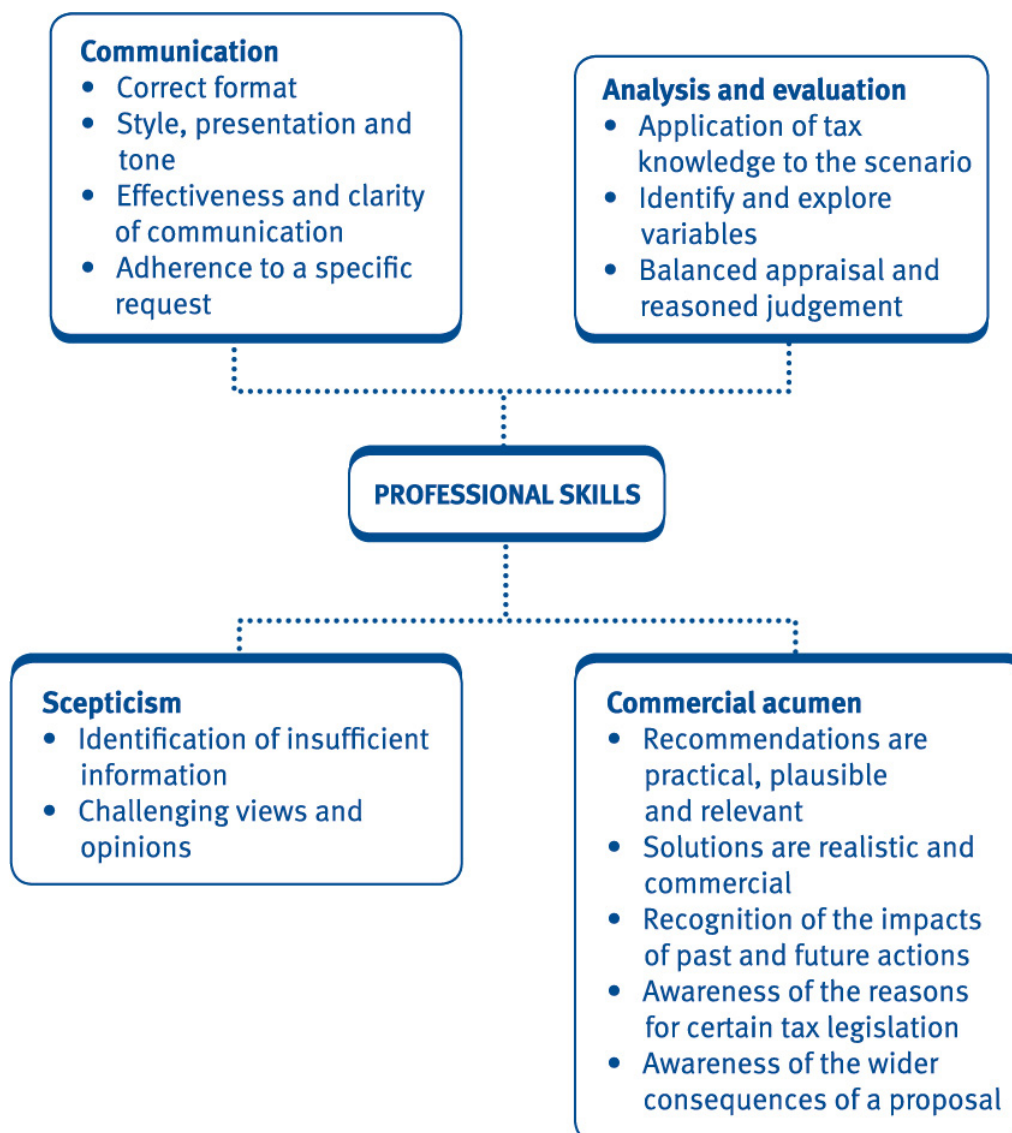
- If 15 minutes are spent reading the examination requirements (it may be sensible to allocate time to this), your time allocation should be 2.25 minutes per mark ($180/80$). This gives 90 minutes for section A and 45 minutes for each section B question.
- If you do not allow a specific amount of time for reading and planning (a more straightforward approach but the risk is that you run out of time) your time allocation will be 2.4 minutes per mark ($195/80$). This gives 97 minutes for section A and 49 minutes for each section B question.
- If you plan to spend more or less time on reading and planning, your time allocation per mark will be different.

In terms of the technical requirements, you should consider how many marks there are for the requirement and then decide how many different points need to be made to achieve these marks. For the Strategic Professional Options examinations this is normally on the basis of one mark per point, possibly with an extra mark for more fully developing the same point.

Chapter summary

The professional skills will be worth 20 marks out of the total 100 in the exam.

Make sure you practise plenty of questions before the exam date, and focus on developing your professional skills as well as your technical skills.



Employability and technology skills

Chapter learning objectives

This chapter contains an overview of the employability and technology skills syllabus area. This is relevant for all ACCA Applied Skills (except LW) and Strategic Professional exams.

Upon completion of this chapter you will be able to:

- use computer technology to efficiently access and manipulate relevant information
- work on relevant response options, using available functions and technology, as would be required in the workplace
- navigate windows and computer screens to create and amend responses to exam requirements, using the appropriate tools
- present data and information effectively, using the appropriate tools.

1 Purpose of chapter

This chapter explains the content included within the employability and technology skills syllabus area. A similar syllabus area is included in all Applied Skills (except LW) and Strategic Professional level syllabi.

ACCA exams utilise software and technology similar to those used in the modern workplace. By studying ACCA exams, candidates will be equipped with both technical syllabus knowledge and practical, applied software skills. The employability and technology skills syllabus area is included within the syllabus to acknowledge this acquired skillset.

2 Content of the employability and technology skills syllabus area

The employability and technology skills syllabus area is outlined in the syllabus and study guide. It consists of the following:

- 1 Use computer technology to efficiently access and manipulate relevant information.
- 2 Work on relevant response options, using available functions and technology, as would be required in the workplace.
- 3 Navigate windows and computer screens to create and amend responses to exam requirements, using the appropriate tools.
- 4 Present data and information effectively, using the appropriate tools.

By using a computer-based examination (CBE), the ACCA has enabled the use of word processing, spreadsheet, screen navigation and data processing functionalities to become part of their assessment range. This replicates the skills used in the modern workplace, whether in accounting practice, in industry or outside of accountancy altogether.

Whilst sitting an exam, candidates will be using the functionality of the CBE software in a variety of ways e.g. to prioritise information within the question data provided, to organise and present their answers in a manageable fashion, to use shortcuts and software functionality to increase efficiency. Skills garnered in the workplace can be used in the examination and vice versa.

This reflects that exams offered at Applied Skills and Strategic Professional are designed to be relevant and accessible to all students. The delivery mode and assessment types require students to demonstrate similar skills to those required in the modern workplace. Offering computer-based exams (CBE) at all levels gives students the opportunity to focus on the application of knowledge to scenarios, using a range of tools – spreadsheets, word processing and presentations. This not only allows students to demonstrate their technical and professional skills, but also their use of the technology relevant to the modern workplace. CBEs, therefore, offers the candidate an examination delivery method that allows them to demonstrate their knowledge and skills with the technology they are most familiar with, in the classroom or at work.

3 CBE support and the ACCA Exam Practice Platform

ACCA candidates can access the ACCA's Exam Practice Platform to practice attempting questions using the CBE software. It is imperative that candidates are familiar with the software before attempting the exam.

The link to the ATX UK Exam Practice Platform access gateway can be found here:

<https://bit.ly/3IRi5OK>

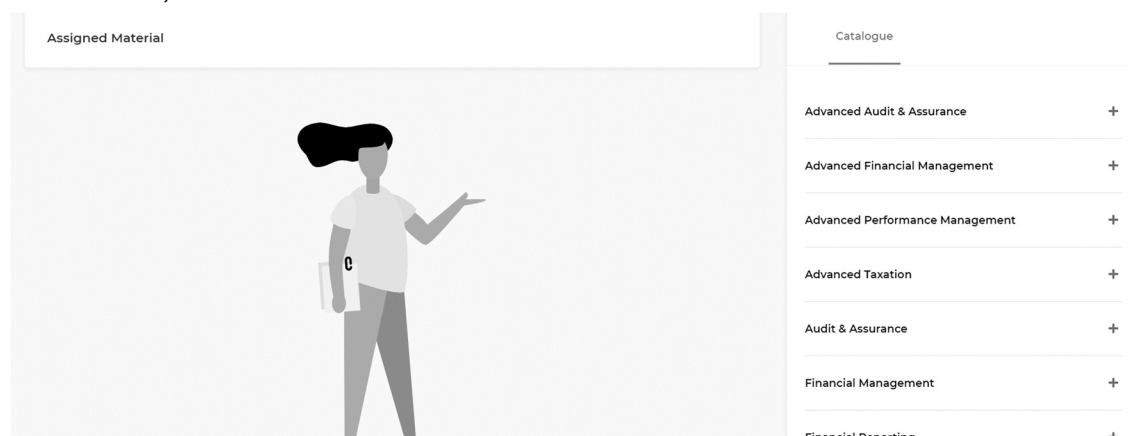
This requires a MyACCA login to access the platform.

Support, access to other exams and more CBE advice can be found here:

<https://www.accaglobal.com/gb/en/student/exam-support-resources.html>

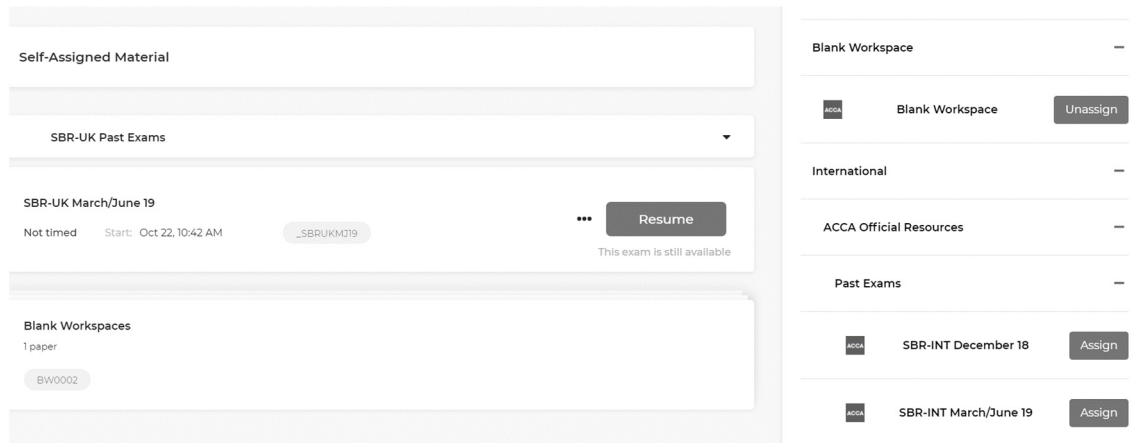
4 Contents of the CBE and Exam Practice Platform

On entering the Exam Practice Platform, candidates will access their dashboard, as follows:



Candidates should click their appropriate exam in the right hand side menu. There they will be able to 'assign' content to their workspace. Candidates can assign a blank workspace or ACCA official resources (which include past exams presented using the CBE software for the candidates to attempt) to their workspace.

This will be added to the candidate's 'Self-Assigned Material' listing as below:



When working within the assignment the candidate will use response options to provide their answer.

The **Response Options** are where the candidate will attempt their answers.

There are up to three types of response option provided, dependent upon the specific syllabus a candidate is studying. Not every option will appear in each exam. Check the exam practice platform for examples of the responses that are commonplace within your exam.

The response options for ATX UK are:

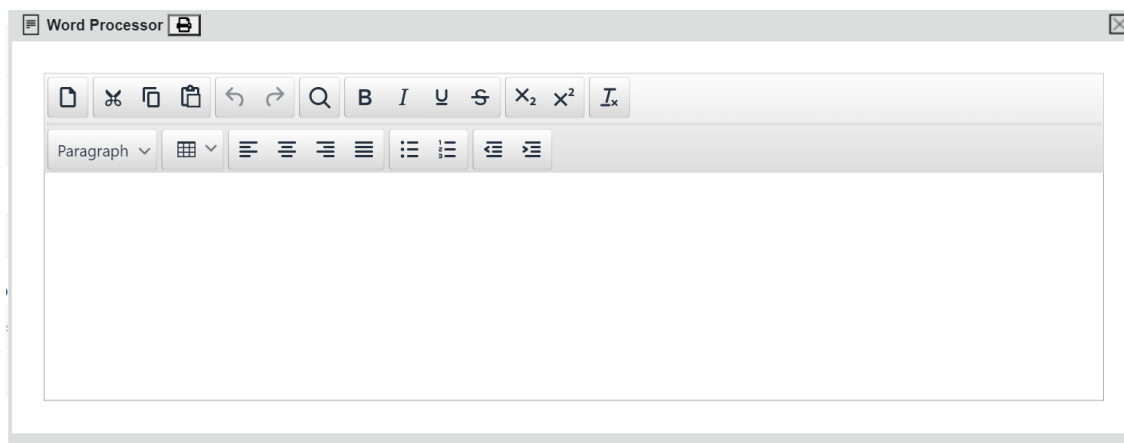
- the word processor, and
- the spreadsheet.

The candidate must determine which of the response options is the most suitable for their specific answer.

These replicate the functionality of widely used software packages. The ACCA has developed this software, for use during home question practice and under exam conditions, to replicate the practical skill sets and work-based behaviours adopted by various industries throughout the world. By studying the ACCA qualification, candidates will improve, not only on their technical knowledge and understanding, but also on skills applied on a daily basis within their work environments. Candidates should practise questions using the CBE platform to ensure they are familiar with the various functions available within their specific examination.

Word Processor

The word processor response option, when relevant, will appear as follows:



This resource has the following advantages and disadvantages:

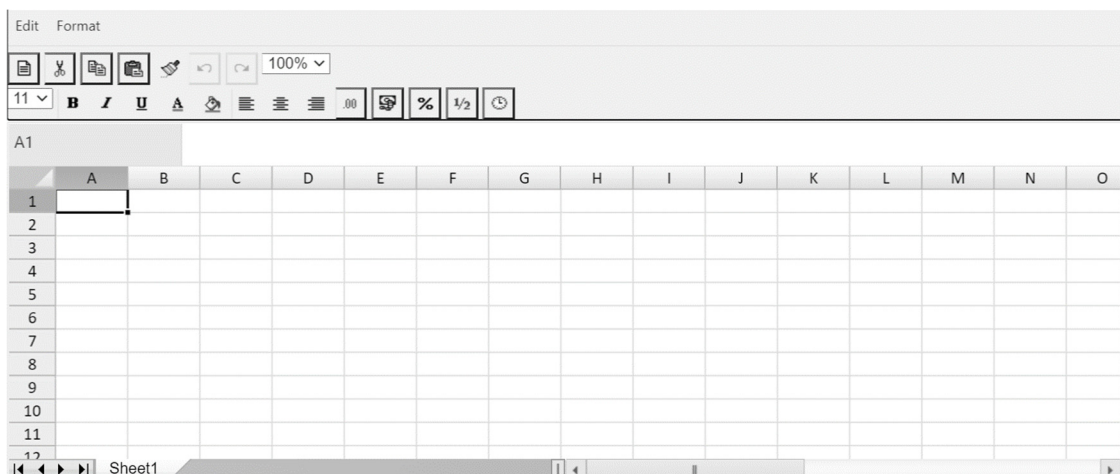
Advantages	Disadvantages
It is easier to continue typing without entering new cells or becoming concerned about cell width	It cannot automatically perform calculations
Answers can be more easily split into paragraphs to make them more visually appealing and easier to mark	Numerical tables can be difficult to label and align
Bullet points can be used to present lists	
Text can be easily aligned and justified	
Superscript and subscript can be easily added to express terms such as 4^2 , for example	

It is, therefore, best suited to discursive answers where candidates are asked, for example, to discuss, analyse or evaluate issues from a scenario or calculation.

The word processing software application could be used in the workplace within the writing of meeting agendas, meeting minutes, external letters, marketing output, briefings, audit reports, textbooks and instructional documentation.

Spreadsheet

The spreadsheet response option, when relevant, will appear as follows:



The spreadsheet software uses the same functionality as other commonly used spreadsheet software. Basic formulae functionality, such as SUM, power functions (e.g. SQRT) and the use of brackets are all reproduced within the ACCA software. Candidates are advised to practise questions using the software so that they are familiar with the functions available and how they can be utilised to the candidate's advantage through improved efficiency.

This resource has the following advantages and disadvantages:

Advantages	Disadvantages
This can quickly and easily perform calculations (e.g. using sums for totals or formulae for calculations)	Text will carry over beyond one cell and may go across and beyond the page width making answers difficult to follow (and mark)
Data within tables can be easily aligned	Bullet points are difficult to use
Shortcut icons can be used to quickly round figures, change numbers to percentages etc	
Tables can easily and quickly be copied when calculations need to be reformed (e.g. for sensitivity analysis, tax calculations for more than one person, financial statements for more than one company etc)	
Column width can be adjusted to label length	

It is, therefore, best suited for performing calculations within the examination e.g. tax computations

Spreadsheet software is ubiquitous in the modern workplace. It has the capacity to record, store and organise huge swathes of data and information relating to all aspects of a business. Examples of only a few of its possible practical applications include the preparation of management and financial accounts, operational controls and record-keeping e.g. expense claims, data analytics, project appraisals, sample size selection and tax computations.

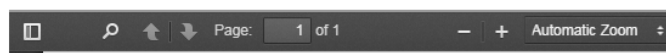
Differences between Practice Platform and live exams

You should be aware that there are some differences between the functionality of the ACCA Practice Platform and the live exams. These differences are set out below:

1 PDF exhibits toolbar

The toolbar on PDF exhibits look and work slightly differently in the Practice Platform and the live exams. These differences are explained in further detail below.

CBE Practice Platform:



Live exam:



2 Selecting text in a PDF exhibit

In the Practice Platform you are able to immediately select text which you can then highlight, strike through or copy. In the live exam you cannot immediately select text. Instead, you will need to select the 'Text Tool' button which will then enable you to select text.

When you open the PDF, it has the *Move Tool* selected:



In order to highlight text in the PDF you need to select the *Text Tool* button instead:



3 Appearance of selected text

In the Practice Platform selected text will appear highlighted/shaded, but in the live exam it is greyed out:

The directors use 'underlying profit' to comment on its financial performance. Underlying profit is a measure normally based on earnings before interest, tax, depreciation and amortisation (EBITDA). However, the effects of events which are not part of the usual business activity are also excluded when evaluating performance.

The following items were additionally excluded from net profit to arrive at 'underlying' profit. In 20X6, the entity had to write off a property due to subsidence and the insurance recovery for this property was recorded but not approved until 20X7, when the company's insurer concluded that the claim was valid. In 20X6, the entity considered issuing loan notes to finance an asset purchase, however, the purchase did not go ahead. The entity incurred costs associated with the potential issue and so these costs were expensed as part of net profit before taxation. The entity

Notes:

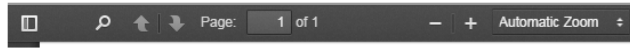
Organisational overview

Data Communications Systems (DCS), a publicly listed company on the small companies' capitalisation (SmallCap) index of a national stock exchange, used to be a privately owned high technology company established 18 years ago by computer engineer, Java Peraya. Due to a rapid expansion over the following years, DCS needed to source additional capital to fund its future growth and was floated on the national stock exchange in 20X6. This allowed Java Peraya to realise his majority shareholding in the private company. 30% of the flotation was purchased by institutional investors and DCS also borrowed long-term funds to leverage the newly issued share capital. Before flotation, the company was almost exclusively financed from the founders' share capital, retained earnings and short-term finance.

4 Find tool in PDF exhibits

The find tool appears at the top of the toolbar in the Practice Platform, but on the left hand side in the live exam:

CBE Practice Platform:



Live exam:



5 Copying and pasting into spreadsheet response area

In order to copy and paste from exhibits, requirements or the scratchpad in the Practice Platform you can either select the cell, double click the cell or select the formula bar and then press Ctrl and V.

In the live exam you can only copy and paste by double clicking the cell or selecting the formula bar and pressing Ctrl and V.

5 Chapter summary

The CBE software will replicate the work that is performed by accountants in a typical workplace. It will be used across the syllabus to support a candidate's answer by providing suitable response options for different types of answers.

These response options will be most suitable in the following instances (when available):

- For discursive answers: it is best to use the word processing option.
- For calculations: it is best to use the spreadsheet option.



Chapter

30

Questions and Answers

1 Corporation tax: computations and administration

There are no questions for this chapter.

2 Calculation of corporation tax income and gains



Lowland Ltd

Question 1

Lowland Ltd is a small unquoted trading company. Lowland Ltd has always had an accounting reference date of 31 December, with its most recent accounts being prepared to 31 December 2022. However, the company now plans to change its accounting reference date to 30 June 2024.

Lowland Ltd has forecast that its results for the 18-month period to 30 June 2024 will be as follows:

- (1) Tax adjusted trading profits, before capital allowances, per six monthly periods will be:

	£
Six months to 30 June 2023	155,000
Six months to 31 December 2023	139,000
Six months to 30 June 2024	145,000
- (2) The tax written-down value of plant and machinery at 1 January 2023 is £22,000. On 30 April 2023 Lowland Ltd purchased new plant costing £39,000.
- (3) Lowland Ltd owned two freehold office buildings that have always been rented out unfurnished. These were both sold. The first building in Reading was sold on 30 June 2023 resulting in a chargeable gain of £46,000, whilst the second building in Guildford was sold on 30 November 2023 resulting in an allowable capital loss of £28,000.
- (4) The building in Reading was let until sold at £53,000 p.a., rent being due quarterly in advance on 1 January, 1 April etc. The building in Guildford was let until 30 September 2022, but had been empty since then. It was decorated at a cost of £10,000 during November 2023 prior to its disposal. Both lettings were at a full rent and Lowland Ltd was responsible for all repairs.
- (5) A dividend of £55,000 was paid on 15 April 2023.
- (6) Lowland Ltd has a 20% shareholding in Mini Ltd, an unquoted trading company. A dividend of £13,750 was received from Mini Ltd on 16 December 2023.

Required:

Advise Lowland Ltd of whether it would be beneficial to:

- (i) prepare one set of accounts for the 18-month period to 30 June 2024, or
- (ii) prepare separate accounts for the 6-month period to 30 June 2023 and for the year ended 30 June 2024.

Your answer should include a calculation of Lowland Ltd's total corporation tax liability for the 18-month period to 30 June 2024 under each alternative, and should state the due date(s) for payment of this tax.

You should assume that the current rates of capital allowances apply throughout and that the tax rates for FY2023 continue to apply in future.

(17 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer.

(3 marks)

(Total: 20 marks)

3 Corporation tax losses



Cosmet Ltd

Question 1

- (a) Cosmet Ltd is a company that manufactures cosmetics. The recent results of Cosmet Ltd are as follows:

	y/e 31.5.2021 £	y/e 31.5.2022 £	p/e 31.12.2022 £	y/e 31.12.2023 £
Trading profit	750,250	500,500	101,999	
Trading loss				(232,790)
Property income	10,000	10,000	10,000	11,000
Bank interest receivable	8,460	7,526	5,076	5,275
Capital (loss)/gain	1,622	(4,000)	2,990	60,400

Required:

- (i) Calculate the taxable total profits for all four periods, assuming that relief is obtained for the loss as soon as possible. **(6 marks)**
- (ii) Calculate the tax repayments arising from the claim. **(2 marks)**

- (b) The company director is thinking about the company's options and has arranged a meeting with you and your tax partner.

She is considering one of the following two options:

- (1) merging with another company which will buy the shares in Cosmet Ltd. The acquiring company is keen to acquire the goodwill and clients of Cosmet Ltd and utilise the losses, or
- (2) changing the products that Cosmet Ltd currently make, and moving into the more lucrative market of making beauty products for Spa Hotels.

Required:

Make brief notes for your meeting with the director on the effect on trading losses of the two options being considered. **(6 marks)**

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer. **(3 marks)**

(Total: 17 marks)

4 Groups and consortia



Longbow Ltd

Question 1

Longbow Ltd wishes to acquire Minnow Ltd and has made an offer to the shareholders of that company which it would like to finalise on 1 October 2023. The share capital of Minnow Ltd is owned equally by A Ltd, B Ltd and C Ltd.

The forecast results of Longbow Ltd and Minnow Ltd for the year ended 31 March 2024 are as follows:

	Longbow Ltd	Minnow Ltd
	£	£
Adjusted trading profit/(loss)	220,000	(140,000)
Capital gain	—	50,000
Interest received on loan notes (gross)	5,250	—

Both Longbow Ltd and Minnow Ltd are UK resident.

Longbow Ltd purchased £150,000 of 7% loan notes issued by an unrelated company on 1 August 2023. On 30 April 2024 the company is to purchase a new freehold factory for £120,000.

Minnow Ltd's capital gain is in respect of the proposed sale of a freehold office building for £150,000 on 10 February 2024. One-quarter of the building has never been used for the purposes of the company's trade.

Neither Longbow Ltd or Minnow Ltd received any dividends during the year ending 31 March 2024.

Required:

Calculate the corporation tax liability for both Longbow Ltd and Minnow Ltd for the year ended 31 March 2024 assuming that all beneficial reliefs are claimed, if:

- (a) Longbow Ltd acquires one-third of Minnow Ltd's share capital from A Ltd on 1 October 2023. **(4 marks)**
- (b) Longbow Ltd acquires two-thirds of Minnow Ltd's share capital from A Ltd and B Ltd on 1 October 2023. **(3 marks)**
- (c) Longbow Ltd acquires all of Minnow Ltd's share capital from A Ltd, B Ltd and C Ltd on 1 October 2023. **(4 marks)**

(Total: 11 marks)



Willow Group

Question 2

Willow Ltd, a UK resident company, has holdings of ordinary shares in other companies, which, apart from Beech Inc, are all UK resident.

90% in Beech Inc (an overseas resident company)

90% in Fig Ltd

85% in Oak Ltd

55% in Pine Ltd

Fig Ltd holds 75% of the ordinary shares of Cherry Ltd, Ash Ltd holds 45% of the shares in Pine Ltd and Beech Inc holds 5% of the shares in Cherry Ltd.

Trading results for each company for the year ended 31 March 2024:

		£
Ash Ltd	Loss	(160,000)
Pine Ltd	Profit	158,000
Willow Ltd	Profit	40,000
Oak Ltd	Loss	(107,000)
Fig Ltd	Profit	294,000
Cherry Ltd	Loss	(15,000)
Beech Inc	Loss	(110,000)

No company had any other source of income or gains.

Required:

Assuming the losses are used in the most tax efficient manner, calculate the UK corporation tax payable by each of the UK companies for the year ended 31 March 2024. **(10 marks)**



North and South

Question 3

Bertrand owns 100% of the issued share capital of two UK resident trading companies, North Ltd and South Ltd. Both companies operate in the retail sector and started trading on 1 April 2023.

The actual and forecast results for both companies are as follows:

	Trading profit/(Loss) £
North Ltd	
Actual for the year ended 31 March 2024	10,000
Forecast for the year ended 31 March 2025	(114,000)
South Ltd	
Actual for the year ended 31 March 2024	160,000
Forecast for the year ended 31 March 2025	200,000

Due to the losses forecast for North Ltd some restructuring of the two companies is required. This is planned to take place on 1 April 2024.

The forecast figures given above for both companies are stated before the effects of this proposed restructuring, which will comprise:

- (1) North Ltd selling one of its retail outlets to a third party for £130,000 with the consideration allocated as follows:

	£
Freehold property	120,000
Inventory (cost £6,000)	10,000
	<hr/>
	130,000
	<hr/>

At the date of sale, the freehold property will have an indexed cost of £80,000.

- (2) As South Ltd has sufficient cash resources it will acquire a replacement retail outlet costing £120,000 with the consideration allocated as follows:

	£
Freehold property	100,000
Inventory	20,000
	<hr/>
	120,000
	<hr/>

Both properties were constructed before 2018.

Required:

- (a) Calculate the actual and forecast corporation tax liabilities of North Ltd and South Ltd for the years ended 31 March 2024 and 31 March 2025 assuming that the objective is to minimise the total tax liability for these years.

Your answer should clearly identify any unrelieved losses carried forward at 31 March 2025. **(4 marks)**

- (b) Explain the weaknesses of the above group structure and advise as to how this position could be improved by making one company a wholly owned subsidiary of the other company. **(4 marks)**

- (c) Recalculate the corporation tax liabilities of North Ltd and South Ltd for the years ended 31 March 2024 and 31 March 2025 assuming that the group restructuring identified at part (b) had been implemented with effect from 1 April 2024 and the objective is again to minimise the total tax liability for these years. **(5 marks)**

You should assume that the rates and allowances for the Financial Year 2023 apply throughout.

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer.

(3 marks)

(Total: 16 marks)

5 Overseas aspects of corporation tax



Bertie Overseas

Question 1

You have recently met with Bertie, a UK resident individual, who requires some preliminary advice concerning setting up an overseas operation.

You ascertain during the course of the meeting that Bertie owns 30% of the share capital and is the managing director of Bertie Ltd a successful UK resident trading company which manufactures lawnmowers in the UK. The remaining shares are held by other third-party individuals.

Bertie Ltd operates on a wholesale basis and currently only sells products in the UK. Bertie, however, believes the time is right for overseas expansion and is considering setting up a distribution operation in the country of Picea ('Bertie Overseas') which will be wholly owned by Bertie Ltd. It is planned that Bertie Overseas will also operate on a wholesale basis and will only buy lawnmowers from Bertie Ltd.

The following additional information is available:

- (1) Bertie Ltd currently pays corporation tax at the main rate.
- (2) The rate of Picean corporation tax is 10%, irrespective of whether the trading entity is a branch or a company incorporated in Picea. Picean tax law only allows the offset of trading losses generated against other profits earned in the same period. Under Picean tax law no withholding tax is deductible on overseas profits remittances. There is no double tax treaty between the UK and Picea.
- (3) The mark up currently achieved by Bertie Ltd, after all selling and distribution costs, on sales to its UK customers is 100%. The mark up on sales to Bertie Overseas will be 80%. Bertie Overseas will be responsible for all of its own selling and distribution costs including meeting carriage costs from the UK. Bertie believes that, in the absence of Bertie Overseas, Bertie Ltd would achieve a comparable mark up on sales to Picea of 85%.
- (4) Setting up the Picean operation will involve the acquisition of some freehold premises as well as necessary vehicles and equipment.
- (5) Local Picean management will be appointed to run the day to day operations of Bertie Overseas. Bertie is considering retaining a high level of ultimate control over Bertie Overseas.
- (6) Bertie Ltd is planning to charge Bertie Overseas interest on any loan finance provided at the rate of 4% per year. If Bertie Overseas were to arrange its own loan finance via an independent bank it would have been charged 6% per year.
- (7) The business plans produced indicate that Bertie Overseas is likely to make a loss for its first trading period and will then produce progressively stronger profits. Once profits are being generated it is planned to remit 25% of these to Bertie Ltd.

Bertie has asked that you write to him setting out the principal business tax issues that need to be considered in advance of a future meeting where these issues will be discussed in more detail.

Required:

Write a letter to Bertie identifying the principal business tax issues that can be identified from the above information regarding the setting up of Bertie Overseas.

You are not required to discuss any employee or VAT issues.

The points covered should include (but not be restricted to) an analysis of whether Bertie Overseas should be set up as a branch or a limited company, the anti-avoidance legislation that HMRC could use to tax the overseas profits in the UK and whether relief will be available in the UK for any Picean taxes paid. **(25 marks)**

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation, scepticism and commercial acumen in your answer. **(5 marks)**

(Total: 30 marks)

6 CGT: Computations and stamp duty land tax



Oti

Question 1

Oti made the following disposals in the tax year 2023/24:

- (1) On 29 June 2023 she sold an antique dining table for £12,500. She bought the table in September 2009 for £8,750.
- (2) On 23 September 2023 she sold her car, a Renault Espace for £8,700. She bought the car for £18,000 in March 2016.
- (3) On 25 December 2023 she sold a commercial property, held as an investment for £485,000. She bought the property for £156,000 in August 2015. Legal costs, estate agent fees and stamp duty land tax totalled £2,700 at the time of purchase and legal fees were £4,075 on the sale of the property.
- (4) On 4 January 2024 she sold a business asset for £37,000. She purchased the asset for £4,000 in October 2019. The asset had been used for the purposes of her self-employed business for the whole period of ownership. The disposal was not part of a disposal of the whole of the business.

Oti has capital losses brought forward at 6 April 2023 of £8,950.

She has taxable income for the tax year 2023/24 of £80,000.

Required:

Calculate Oti's after tax sales proceeds realised from the above disposals. **(10 marks)**

7 CGT: Variations to computations



Dante

Question 1

Dante had the following capital transactions during the tax year 2022/23.

- (1) He gave away a greyhound on 1 May 2022, which he had bought assuming that it had a good pedigree for £8,000 in 2011. It had come last in every race it had been entered in and had no value when he gave it away.
- (2) Dante had some unquoted shares which he sold for £6,000 on 2 August 2023. These had been left to him in his uncle's will in July 2007 when the probate value was £7,500.
- (3) Dante purchased a lease with 39 years to run on 12 February 2016 for £200,000. Dante used the property wholly for the purposes of his trade until 19 October 2023 when he sold the lease for £275,000. This was not part of the disposal of the whole of the business.
- (4) He purchased a painting for £9,000 on 14 May 2006 which was destroyed in a flood on 25 December 2023. He received insurance proceeds of £50,000 and decided not to buy more paintings.
- (5) After the shock of losing the painting, Dante gifted his only other antique, a ring worth £1,000 to his mother on 26 December 2023. He had acquired this from a market in the summer (July) of 2017 for £5.
- (6) Dante bought a ten-hectare plot of land for £130,000 in March 2014 for investment purposes. In June 2020, Dante sold two hectares of the land for £30,000. The remaining eight hectares were worth £150,000. On 28 March 2024 Dante sold the remaining eight hectares for £205,000.

Dante's only income is employment income of £36,620. He has no plans to sell any other assets in the near future.

Dante paid £4,000 into his personal pension scheme in the tax year 2023/24.

Required:

- (a) Calculate the capital gains tax payable by Dante for the tax year 2023/24 and state the due date of payment. **(15 marks)**
- (b) Explain, with supporting calculations, why it would have been preferable for CGT purposes if Dante had delayed the sale of the plot of land until 6 April 2024 (assuming the sale proceeds remained the same). **(5 marks)**

You should assume that the rates and allowances for the tax year 2023/24 continue to apply in future years. **(Total: 20 marks)**

Relevant lease percentages are:

39 years	94.842
32 years	89.354
31 years	88.371

8 Shares and securities for individuals and stamp duty



Emma

Question 1

Emma made the following disposals during the year ended 5 April 2024:

- (1) On 9 February 2024 she sold 1,050 shares in Apple plc for net proceeds of £95,000.

The history of this shareholding is as follows:

March 2019	purchased 400 shares for £10,000
January 2020	took up 1 for 4 rights issue at £30 per share
December 2021	purchased a further 200 shares for £8,000
January 2023	bonus issue of 1 for every 2 shares

Emma does not work for the company and her shares are a very small percentage of the shares in issue.

- (2) On 19 March 2024 she gifted to her sister three out of her shareholding of ten shares in Willow Ltd, her unquoted personal trading company. The value of the three shares gifted was £50,000.

Emma acquired the shares at a cost of £100 per share when she set up the company many years ago. Emma had never worked for the company. Gift holdover relief will not be claimed.

- (3) On 15 September 2023, she sold National Savings Certificates worth £600. Emma acquired the certificates from her grandfather's estate following his death in August 2018. The shares were valued at £500 at that time.

- (4) Emma had acquired 100 ordinary shares in Bridge plc for £9,200 in June 2010. She had never worked for Bridge plc. In January 2024, Bridge plc was subject to a takeover.

In return for each share Emma received the following: £350 cash, and a loan note in Poker plc worth £50.

Emma has taxable income of £160,000 for the tax year 2023/24.

Required:

Calculate Emma's capital gains tax payable for the tax year 2023/24.

(15 marks)

9 CGT: Reliefs for individuals



Harry and Celine

Question 1

- (a) Harry owns 60 per cent of the ordinary share capital of X Ltd, an unquoted trading company.

He acquired his holding many years ago for £70,000 and since that date he has been a full-time working director of the company.

The following information has been extracted from the accounts of X Ltd at 30 November 2023.

	£
Buildings	480,000
Investments in other companies (not in the same industry)	80,000
Plant and machinery	16,000
Net current assets	32,333

The plant and machinery consists entirely of movable plant with no single item costing, or having a current value of, more than £6,000.

Assume today's date is 1 December 2023.

On 1 January 2024 Harry intends to retire from the company, and plans to gift his entire shareholding to his daughter. The market value of the shareholding is estimated to be worth £365,000.

In November 2023 Harry sold his house for net proceeds of £503,000. The house cost £38,000 in September 2001. He intends to use the proceeds received from the sale of his house to build a new flat in Spain.

Harry lived in the house throughout his ownership except for a period of one year, six years ago. He moved out and let the property while he lived and worked as the manager of the local pub. He returned to his house one year later.

Both Harry and his daughter are higher rate taxpayers.

Required:

Compute the expected capital gains tax liability for the tax year 2023/24 assuming Harry gifts the shares to his daughter and assuming all available reliefs are claimed, which are beneficial.

(6 marks)

- (b) The building owned by X Ltd was originally purchased by Celine for use in her unincorporated business. She sold it to the company on 1 April 2023 after ceasing to trade. Celine has already paid the capital gains tax liability for the tax year 2022/23 arising on the disposal.

Celine is now considering buying some commercial property with a view to setting up a new business. She would like to know if there are any CGT advantages in purchasing new property and setting up a new business.

Required:

Prepare notes for a meeting with Celine covering the CGT advantages of her proposal and any conditions she should consider.

(10 marks)

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation and commercial acumen in your answer.

(4 marks)

(Total: 20 marks)

10 An introduction to inheritance tax

There are no questions for this chapter.

11 IHT – special valuation rules, reliefs, and the death estate



Alwyn

Question 1

Alwyn is a wealthy individual aged 57, married to Rhian, aged 54. The couple have two children, Iwan, aged 34 and Elinor, aged 37, who both have children of their own.

Alwyn currently owns 60% of the issued share capital of GG Ltd, a UK resident trading company, which he set up in 1992. The remaining shares are held, 20% by his daughter Elinor and 20% by unconnected third parties.

Alwyn has made the following gifts during his lifetime. Alwyn agreed that he would pay any inheritance tax arising on these gifts.

4 July 2012	£376,000 cash gift to a discretionary trust.
4 March 2017	£10,000 cash as a wedding gift to his son Iwan.
4 March 2017	20% of the shares in GG Ltd to his daughter Elinor.
	At this time the GG Ltd shares were valued as follows:
	£
	20% 100,000
	60% 450,000
	80% 600,000
	100% 800,000
4 June 2019	A further £100,000 cash gift to the discretionary trust created on 4 July 2012.

Required:

Explain the IHT implications arising from the lifetime gifts made between 4 July 2012 and 4 June 2019.

Your answer should include a calculation of any IHT payable and an explanation of any exemptions or reliefs available.

You are not required to explain the implications for the trustees of the discretionary trust.

(12 marks)

12 IHT overseas, administration and tax planning

**Mary****Question 1**

Mary is a wealthy widow who has asked for your advice in respect of a number of gifts that she is planning to make in the near future.

Her only previous gift was a gross chargeable transfer of £335,000 into a discretionary trust two years ago.

The proposed gifts are as follows:

- (a) A gift of a holiday cottage worth £100,000 to her nephew Pedro.
As a condition of the gift, Mary would have the free use of the cottage for six months each year.
- (b) A gift of an antique clock worth £10,000 to her granddaughter Jane in respect of her forthcoming wedding.
- (c) A gift of 20,000 £1 ordinary shares in DEF Ltd into a discretionary trust for the benefit of her nieces and nephews.

Mary currently holds 30,000 shares in the company. She acquired the shares one year ago.

DEF Ltd is an unquoted trading company with a share capital of 200,000 £1 ordinary shares.

A 5% holding is worth £10 per share, whilst 10% and 15% holdings are worth £13 and £16 per share respectively.

- (d) A gift of agricultural land and buildings with an agricultural value of £160,000 to her son David.

The land was bought ten years ago, and has always been let out to tenants.

The most recent tenancy agreement started in 2017, and comes to an end in six months' time. Mary has obtained planning permission to build ten houses on the land.

The value of the land with planning permission is £280,000.

David owns the neighbouring land, and the value of this will increase from £200,000 to £250,000 as a result of the gift.

Mary will pay the inheritance tax arising from the gift into the discretionary trust. Any inheritance tax arising on the other gifts will be paid for by the respective donee.

Required:

Advise Mary of the inheritance tax implications arising from the above gifts, ignoring annual exemptions. **(12 marks)**



Thelma

Question 2

Assume today's date is 30 June 2024.

Thelma is aged 78 years and a higher rate taxpayer. She is married to Gordon, who is independently wealthy in his own right. They have one child, Louise.

Thelma has unfortunately recently become terminally ill and is expected to live for only another four years.

She owns the following assets:

- (1) 10,000 ordinary £1 shares in Blackbird plc, a quoted UK resident trading company with an issued share capital of 1 million ordinary shares. The company prepares its accounts to 31 March each year.

The shares are currently quoted at 1,460p – 1,468p. Thelma acquired 5,000 of her shares in June 2007 for £25,000. The remainder of the shares were acquired by way of a rights issue in June 2013 for a further £50,000.

Thelma was a director of this company for many years until she had to retire for health reasons on 31 May 2023.

- (2) A 25% beneficial interest in £100,000 10% loan stock in Robin plc, a quoted UK resident trading company.

This loan stock is currently quoted at 102p – 106p and is held jointly with Gordon who has always owned the remaining 75% beneficial interest in it. This loan stock was acquired in June 2014 for £90,000.

- (3) Main residence valued at £500,000.
- (4) Three antique plates which are part of a set of six. Thelma bought her three plates in June 2015 for £2,500. On the same day Gordon bought two of the plates for £1,500 whilst Louise bought the remaining plate for £750. The values of the plates are currently:

	£
1 plate	1,000
2 plates	2,200
3 plates	3,800
4 plates	6,000
5 plates	10,000
6 plates	20,000

- (5) Cash deposits amount to £145,000.

- (6) Sundry personal chattels collectively worth £20,000 with no individual asset worth more than £5,000.

Under the terms of Thelma's will, all of her assets are to be left to Louise with the exception of the house and her sundry personal chattels which are bequeathed to Gordon.

Due to her failing health, Thelma and her family are currently considering whether she should either:

- (i) gift all of her assets, with the exception of the house and her sundry personal chattels, to Louise upon her death in four years' time, or
- (ii) make these gifts to Louise now.

In four years' time her assets are expected to be valued at the following amounts for inheritance tax purposes:

	£
Blackbird plc shareholding	200,000
100% of the Robin plc loan stock	100,000
Residence	600,000
Antique plates	10,000
Cash deposits	160,000
Sundry personal chattels	20,000
	<hr/>
	1,090,000
	<hr/>

The only previous gift made by Thelma was a cash gift, net of annual exemptions, of £360,000 made to Louise in September 2022.

Required:

Advise Thelma whether she should make the transfers of the selected assets to Louise:

- (i) upon her death in four years' time, or
- (ii) 6 July 2024.

Your answer should consider the likely IHT and CGT implications and should include a calculation of any capital taxes likely to arise under each option.

Stamp duty and stamp duty land tax should be ignored.

You should assume that the rates and allowances for the tax year 2023/24 continue to apply. **(18 marks)**

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer. **(4 marks)**

(Total: 22 marks)

13 The taxation of trusts



The Wood Discretionary Trust

Question 1

You are a member of the tax team in the firm 'Tax & Co'. In a few days' time you have a meeting set up with potential new clients.

The clients are about to become the trustees of 'The Wood Discretionary Trust' which is to be set up under the terms of Timo's will following his recent death.

Required:

Make brief notes for the meeting with the potential trustees detailing, for the creation of, operation of, and distributions from, the trust:

- (a) The income tax implications for the trustees and the beneficiaries.
- (b) The CGT and IHT implications for the trustees and beneficiaries.

(15 marks)

14 Ethics

There are no questions for this chapter.

15 Personal tax administration

There are no questions for this chapter.

16 Income tax: Computation

**Danny****Question 1**

Danny has the following income and outgoings in the tax year 2023/24.

	£
Salary and commission from his employer 'Flyhigh Ltd' (PAYE of £3,201 collected)	28,505
Benefits, taxable as employment income	2,100
Building society interest	2,500
UK dividends	1,300
Qualifying loan interest paid to buy shares in 'Flyhigh Ltd'	1,500

On 15 November 2023 Danny and his civil partner, Ben, jointly bought a property that has been let out as unfurnished accommodation. The taxable property income for the tax year 2023/24 is £4,300. No declaration has been made in respect of this source of income.

From 6 April 2024 Danny's salary will increase to £50,000.

Ben utilises his personal allowance and is a higher rate taxpayer.

Required:

- (a) Calculate the income tax payable by Danny for the tax year 2023/24. **(5 marks)**
- (b) Explain how Danny's salary increase will affect the amount of income tax due on his savings income in the tax year 2024/25 and future years. **(3 marks)**

Assume tax rates and allowances for the tax year 2023/24 apply in the future.

(Total 8 marks)



Blanca

Question 2

Assume today's date is 30 June 2024.

Blanca is married to Jorge, who is independently wealthy in his own right. They have one child, Carlota.

Blanca owns the following assets:

- (1) 10,000 ordinary £1 shares in Bluebird plc, a quoted UK resident trading company with an issued share capital of 1 million ordinary shares. The company prepares its accounts to 31 March each year.

Blanca was a director of this company for many years until she had to retire for health reasons on 31 May 2023. During the tax year 2023/24 she earned £14,500 in director's fees from Bluebird plc.

The company has paid the following dividends in recent years:

Year ended	Dividend	Payment date
31 March 2023	27.8 pence per share	30 April 2023
31 March 2024	30 pence per share	30 April 2024

- (2) A 25% beneficial interest in £100,000 10% loan stock in Chaffinch plc, which is quoted on the UK stock exchange. This loan stock is held jointly with Jorge who has always owned the remaining 75% beneficial interest in it.

The couple has not made a declaration of beneficial interest to HMRC in respect of this asset. This loan stock is a qualifying corporate bond.

- (3) Cash deposits amount to £145,000, which generated gross interest receipts in the tax year 2023/24 of £5,250.

Required:

- (a) Calculate Blanca's tax year 2023/24 income tax liability. **(5 marks)**
- (b) Advise Blanca and Jorge whether it would be beneficial to make a declaration of beneficial interest to HMRC in respect of the loan stock held in Chaffinch plc.

Detailed calculations are not required for this part of the question.

(3 marks)

(Total: 8 marks)

17 Employment income and related NIC

**Leonor****Question 1**

Assume today's date is 1 June 2024.

Leonor has been employed as the sales director of Golden Tan plc since 2007. She earns an annual salary of £32,000 and is provided with a petrol-driven company car, which has a CO₂ emission rate of 102g/km and had a list price when new of £22,360. In April 2023, when she was first provided with the car, Leonor paid the company £6,100 towards the capital cost of the car.

Golden Tan plc does not pay for any of Leonor's private petrol and she is also required to pay her employer £50 per month as a condition of being able to use the car for private purposes.

On 1 December 2023, Golden Tan plc notified Leonor that she would be made redundant on 28 February 2024. On that day, the company paid her, her final month's salary together with a payment of £8,000 in lieu of the three remaining months of her six-month notice. In addition, the company paid her £17,500 in return for agreeing not to work for any of its competitors for the six-month period ending 31 August 2024.

On receiving notification of her redundancy, Leonor immediately contacted Joe, the managing director of Summer Glow plc, who offered her a senior management position leading the company's expansion into Eastern Europe. Summer Glow plc is one of Golden Tan plc's competitors and one of the most innovative companies in the industry, although not all of its strategies have been successful.

Leonor has agreed to join Summer Glow plc on 1 September 2024 for an annual salary of £39,000. On the day she joins the company, Summer Glow plc will grant her an option to purchase 10,000 ordinary shares in the company for £2.20 per share under a non-tax advantaged share option scheme. Leonor can exercise the option once she has been employed for six months but must hold the shares for at least a year before she sells them.

The new job will require Leonor to spend a considerable amount of time in London. Summer Glow plc has offered Leonor the exclusive use of a flat that the company purchased on 1 June 2021 for £165,000; the flat is currently rented out. The flat will be made available from 1 September 2024. The company will pay all of the utility bills relating to the flat as well as furnishing and maintaining it. Summer Glow plc has also suggested that if Leonor would rather live in a more central part of the city, the company could sell the existing flat and buy a more centrally located one, of the same value, with the proceeds.

Required:

(a) Calculate Leonor's employment income for the tax year 2023/24.
(4 marks)

(b) (i) Advise Leonor of the income tax implications of the grant and exercise of the share options in Summer Glow plc on the assumption that the share price on 1 September 2024 and on the day she exercises the options is £3.35 per share.

Explain why the share option scheme is not free from risk by reference to the rules of the scheme and the circumstances surrounding the company.
(4 marks)

(ii) List the additional information required in order to calculate the employment income benefit in respect of the provision of the furnished flat for the tax year 2024/25.

Advise Leonor of the potential income tax implications of requesting a more centrally located flat in accordance with the company's offer.
(4 marks)

You should assume that the rates and allowances for the tax year 2023/24 apply throughout this question.

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, scepticism and commercial acumen in your answer.
(3 marks)

(Total: 15 marks)

18 Property and investment income



Polina

Question 1

On 31 December 2023 Polina made a gift of a house in London to her brother Maksim.

Maksim is to rent out the house in London, either unfurnished or as furnished holiday accommodation. In either case, the roof of the house must be repaired at a cost of £24,000 before it will be possible to let the house. The roof was badly damaged by a gale on 5 December 2023.

If the house is let unfurnished, then Maksim will have to decorate it at a cost of £3,600. The forecast rental income is £28,000 p.a.

If the house is let as furnished holiday accommodation, then the house will be converted into two separate units at a cost of £41,000. The total cost of furnishing the two units will be £9,000.

This expenditure will be financed by a £50,000 bank loan at an interest rate of 8% p.a. The total forecast rental income is £45,000 p.a., although 22.5% of this will be deducted by the letting agency. Other running costs, such as cleaning, will amount to £3,500 p.a. in total.

Maksim is a higher rate taxpayer and plans to sell the house when he retires at age 60, and anticipates making a substantial capital gain.

Required:

Advise Maksim of the tax implications of letting out the house in London either

- (i) unfurnished, or
- (ii) as furnished holiday accommodation.

Your answer should include details of the tax advantages of letting the house as furnished holiday accommodation. **(10 marks)**

19 Pensions



Luciana

Question 1

Assume today's date is 1 January 2024.

Luciana has approached you for some advice concerning pensions. She is single and has no children and informs you that she owns all of the shares in Scott Engineering Ltd, a company which has been trading since April 2008.

The company prepares its accounts to 31 March each year and pays corporation tax at the main rate.

Whilst the profits in the earlier years of the business have been reinvested back into the firm, Scott Engineering Ltd is now more established and over the last few years Luciana has been withdrawing more funds from the business.

She is now keen to put money aside for her retirement in ten to twelve years' time and wants to know more about the options open to her.

Luciana's expected income from the company for the tax year 2023/24 is a salary of £15,000 and dividends of £51,500. Luciana has no income other than from Scott Engineering Ltd.

Required:

- (a) Assuming Luciana wishes to set up a personal pension scheme in the tax year 2023/24 advise her of:
- (i) The maximum pension contributions that she can make in the tax year 2023/24 and by when these should be paid to obtain relief. **(3 marks)**
 - (ii) The way in which tax relief will be given if she pays the pension contributions personally.
Your answer to this part should include a calculation of the effect of making such contributions on her tax year 2023/24 income tax liability. **(3 marks)**
 - (iii) The tax implications of Scott Engineering Ltd making contributions into her personal pension scheme and the factors to be considered in deciding whether she or the company should pay these contributions.
Detailed calculations are not required for this question part. **(6 marks)**
- (b) Briefly advise Luciana of any alternative pension arrangements that could be made.
You are not required to comment on the benefits that may ultimately be received under such arrangements. **(3 marks)**
- (Total: 15 marks)**

20 Overseas aspects of income tax and capital gains tax



Miguel

Question 1

Miguel was born and lived in Portugal all of his life. He moved to the UK to work full time at his company's headquarters in Manchester on 6 January 2024 and started work on 13 January 2024.

His contract is for three years and during that time he plans to stay in the UK and will only return to Portugal for the occasional short break. He plans to return to his company's Lisbon office in Portugal at the end of the contract in the UK.

Miguel will be paid £44,000 salary p.a. by the UK company. He will also receive rental income of £28,000 p.a. (UK equivalent) on one of his two Portuguese homes while he is in the UK. This rent will be retained in his Portuguese bank account.

Miguel's employment package includes the following:

- (1) Company car – costing £28,000 with CO₂ emissions of 123g/km. All petrol will be provided by the company.
- (2) Private medical insurance – costing £1,431.
- (3) The company has bought a flat for his use, costing £187,000. The annual value of the property is £4,500. The company will meet all the expenses of running the flat which are estimated to be in the region of £5,700 per annum. The company have furnished the flat at a cost of £49,000. Miguel will pay rent of £1,300 per month to the company for the use of the flat.
- (4) The company has arranged for Miguel's daughter to attend a local private school starting on 5 September 2024. The cost will be £1,500 per month.
- (5) Miguel is provided with a mobile phone, and it is estimated that he spends about £135 per month on calls.
- (6) Employees of the company are allowed to use a corporate membership at the local health club costing £220 per month.

Miguel also has a number of investments in the UK and overseas which have yielded income as follows:

		Remitted to the UK
	£	£
UK dividends	4,000	
Portuguese dividends	3,150	2,500
Portuguese bank interest	2,900	1,300
UK bank interest	1,100	

The figures for the Portuguese income are shown before the deduction of withholding tax at 10%.

Required:

- (a) Discuss the factors HMRC will use to decide whether Miguel is resident and domiciled in the UK in the tax years 2023/24 and 2024/25 and explain the impact of this on his income tax computation. **(9 marks)**
- (b) Calculate Miguel's income tax liability for the tax year 2024/25, on the basis of the information given above, assuming that the 2023/24 tax rates and allowances continue to apply. **(16 marks)**

(Total: 25 marks)



Roberta

Question 2

Roberta has always lived in the UK until December 2023 when she left the UK to take up a full-time contract working abroad. She started work on 2 January 2024 and plans to return to the UK in June 2027 as her contract is due to end on 31 May 2027.

She intends to travel elsewhere in the world on her holidays from work and does not plan to return to the UK until the end of her contract. Once she returns to the UK however she does not plan to leave again other than for short holiday breaks and will permanently settle in the UK.

Whilst she is working abroad she plans to sell the following two assets:

In May 2024 she will sell an asset for £195,000 that she bought in June 2017 for £76,000.

In July 2024 she plans to sell another asset for £26,500. She bought the asset in February 2016 for £54,000.

Neither of the assets are UK land or buildings.

Required:

- (a) Explain Roberta's tax status in the tax years 2023/24 to 2027/28.
(8 marks)
- (b) Explain how Roberta will be taxed on her chargeable gains arising in the tax year 2024/25.
(5 marks)

(Total: 13 marks)

21 New and ongoing unincorporated businesses

**Ali****Question 1**

Ali has been in business as a sole trader for many years as a publisher. He had an illness at the end of 2023 which resulted in his profits falling unexpectedly. The results for the last few tax years, and the projected profits for the next tax year, are as follows:

Tax year:		£
2022/23	Profit	55,000
2023/24	Loss	(18,000)
2024/25	Profit	26,000
(forecast estimate)		

Ali also had other income and outgoings as follows:

	2022/23	2023/24	2024/25
	£	£	£
Bank interest	8,690	5,400	0
Income from residential property	9,200	7,820	6,840

During the tax year 2023/24, to realise some cash funds, he sold one of the properties, an apartment, which he let and made a chargeable gain of £20,600. The property was purchased in 1999.

Ali had unused capital losses of £14,450 at the beginning of the tax year 2023/24.

Required:

Advise Ali of the best method of utilising the loss for the tax year 2023/24 and calculate the taxable income and taxable gains for all relevant tax years assuming your advice is taken.

Assume rules, rates and allowances for the tax year 2023/24 apply throughout. **(10 marks)**



Lotte and Fien

Question 2

- (a) Assume that today's date is 1 December 2023.

Lotte is married to Fien and the couple have one child who is six years old.

Lotte has been employed since 2009 earning £55,000 per annum. From 6 April 2024 she will have a source of property income of £55,000 per year.

Lotte intends to cease her current employment on 31 December 2023, and start trading as a self-employed businesswoman on 1 January 2024 preparing accounts to 31 March each year. Her business plan shows profits in the region of £40,000 per year, before any payment to her wife, Fien.

Fien has been employed as a bookkeeper since 2011, earning £1,100 per month. She will also cease her current employment on 31 December 2023 and will keep the books and prepare the accounts for Lotte's business from 1 January 2024. She will continue to work the same number of hours per week as she does in her current employment.

Lotte would like some advice on the taxation implications of involving her wife, Fien, in her business either as an employee, or, alternatively, by taking her into partnership as an equal partner.

Lotte has never previously had dealings with HMRC, so would also like details as to when she should notify HMRC about her new business for income tax purposes; when her 2023/24 self-assessment income tax return is due; and how she should pay the income tax due on the profits made by the business in both the first and subsequent years.

Required:

- (i) Evaluate the taxation implications for the couple of:

- (1) Lotte employing her wife Fien, and
- (2) taking her into partnership as an equal partner.

Support your answer with calculations of the income tax (IT) and national insurance contributions (NICs) payable, based on the expected trading results for a full year of operation and the tax rates and allowances for the tax year 2023/24.

(11 marks)

- (ii) State the information Lotte requires concerning tax administration.

(4 marks)

(b) Assume that today's date is 1 May 2024.

Lotte decided to form a partnership with her wife, Fien, sharing profits and losses equally.

The business in fact showed a loss of £40,000 for the first tax year, 2023/24, but profits of £40,000 per annum are still anticipated for future years.

Required:

Identify the loss reliefs available to Lotte and explain which of the available reliefs would be most beneficial for her to claim.

Support your answer with calculations of the income tax (IT) saving achieved in each case. **(10 marks)**

Assume that the tax rates and allowances for the tax year 2023/24 apply throughout this question.

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, scepticism and commercial acumen in your answer. **(5 marks)**

(Total: 30 marks)

22 Cessation of an unincorporated business



Jane

Question 1

You should assume today's date is 1 March 2024.

Jane has been running a small restaurant business as a sole trader since 1 September 2008. She has decided to sell her business, and needs some advice concerning the tax implications.

Offer for sale of business:

- Jane has accepted an offer from Hollywood Ltd, an unconnected company quoted on the Alternative Investment Market, to purchase her business.
- Hollywood Ltd would like to complete the purchase on 31 March 2024.
- The purchase consideration will consist of either cash or ordinary shares in Hollywood Ltd, or a mixture of cash and shares.
- Jane will become an employee of Hollywood Ltd from 1 April 2024 on an annual salary of £60,000.
- If the consideration is taken wholly in the form of shares in Hollywood Ltd, then Jane's holding will represent 7.5% of the company's total share capital.

Trading results:

- Jane's trading profits and losses are as follows:

Tax year	£
2020/21	15,000
2021/22	6,000
2022/23	15,000
2023/24	10,000
2024/25	(19,500)

Forecast market values of Jane's business assets:

- The market values of the assets to be sold, at 31 March 2024 are:

	£
Premises (bought for £335,000 in 2017)	365,000
Goodwill	50,000
Inventory (cost plus 5%)	8,300
Shelving and restaurant fittings (all below cost)	10,000
Van (used 85% for business purposes)	4,700
	<hr/>
Total value	438,000
	<hr/>

Other income:

- Jane currently has no other income. In addition to her salary from Hollywood Ltd, she will have savings and dividend income of approximately £20,000 p.a. for 2024/25 onwards, regardless of whether the consideration is taken as cash or shares.

Required:

- Outline briefly the loss relief options available and explain their relative merits in Jane's situation. **(6 marks)**
- Explain why there would be no capital gains tax liability on the transfer of Jane's business in exchange for shares.

Calculate the maximum cash proceeds that Jane could receive without giving rise to a capital gains tax liability, and suggest how much cash Jane should actually receive. **(6 marks)**

You should assume that the tax rates and allowances for the tax year 2023/24 apply throughout.

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer.

(4 marks)

(Total: 16 marks)



Barbara

Question 2

Barbara is a higher rate taxpayer. She has carried on her retail jewellery business as a sole trader since April 1992. On 1 July 2023 she transferred the business as a going concern to Bangle Ltd, an unquoted company she formed for that purpose. Bangle Ltd allotted 200,000 £1 ordinary shares, valued at par, in settlement of the consideration for the transfer. The net assets transferred to the company were as follows:

	Cost/MV £	Acquisition date	Market value 1 July 2023 £
Freehold trade premises	65,000	(1.4.1992)	165,000
Shop fittings	6,000	(1.4.1992)	5,000
Shop front and canopy	13,165	(1.7.1993)	8,000
Inventory			109,000
Bank/cash			3,000
			<hr/>
			290,000
Less: Current liabilities			(90,000)
			<hr/>
Net assets transferred			200,000
			<hr/>

Capital allowances were claimed on the shop fittings but not on the shop front and canopy.

Barbara made no other disposals in the 2023/24 tax year.

Required:

- (a) (i) Compute the chargeable gain arising after incorporation relief as a result of the transfer, and the base cost of the shares received by Barbara. **(5 marks)**
- (ii) Compute the capital gains tax payable in the tax year 2023/24 if, in March 2024, Barbara sold 80,000 of her new shares for net proceeds of £90,000. **(3 marks)**

(b) Calculate the chargeable gains arising

- Had the consideration for the transfer been settled by
 - the allocation of 150,000 £1 ordinary shares at par, and
 - the balance being left on loan account, and
- Barbara had, in March 2024, sold 80,000 shares to her sister for £81,000 when their true value was, as before, £90,000.

Assume that incorporation relief is not disapplied, and that a joint claim for gift holdover relief is made. **(5 marks)**

(c) Assuming that Barbara intends to keep her shares in Bangle Ltd for several years, briefly explain any alternative tax efficient method of transferring the chargeable assets of her business to Bangle Ltd.

You are not to consider the possibility of Bangle Ltd registering as an enterprise investment scheme company. **(4 marks)**

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer. **(3 marks)**

(Total: 20 marks)

23 Partnerships – income tax and capital gains tax



Dafydd and Myfanwy

Question 1

Dafydd and Myfanwy have been in partnership together since 1 December 2008.

The partners sold their business on 30 November 2023 for its market value of £520,000.

The partnership assets at 30 November 2023, and the capital gains arising on the disposal, were as follows:

	Market value	Capital gain
	£	£
Freehold property	322,000	97,000
Goodwill	100,000	100,000
Plant and machinery	58,000	0
Net current assets	40,000	0
	<hr/>	<hr/>
	520,000	197,000
	<hr/>	<hr/>

The taxable trading income for the final four tax years, before allocation between the partners, was as follows:

		£
2020/21 Y/e 5 April 2021	Profit	19,000
2021/22 Y/e 5 April 2022	Profit	19,500
2022/23 Y/e 5 April 2023	Profit	15,200
2023/24 Y/e 5 April 2024	Loss	(37,000)

Profits, losses and capital have always been shared 40% to Dafydd and 60% to Myfanwy.

Dafydd is single and had employment income from a part time job as follows:

	£
2020/21	7,350
2021/22	12,650
2022/23	12,850

He has capital losses brought forward at 6 April 2023 of £25,000.

Myfanwy is single and also has no other income or outgoings apart from bank interest received of £3,850 on 1 December 2023 from investing the proceeds of sale of her holiday cottage. The cottage had been sold in June 2023, and the chargeable gain was £5,500.

Assume the tax year 2023/24 rates and allowances apply to all years.

Required:

- (a) Calculate the chargeable gains in respect of the partnership that will be taxed on Dafydd and Myfanwy for the tax year 2023/24. **(3 marks)**
- (b) (i) Advise the partners of the possible ways of relieving the partnership loss for the tax year 2023/24 and which loss relief claims would be the most beneficial. **(5 marks)**
- (ii) After considering the advice in (i), calculate the partners' taxable income for the tax years 2020/21 to 2023/24 and their taxable gains for 2023/24. **(5 marks)**

(Total: 13 marks)

24 Family companies and related planning scenarios



Aisling

Question 1

Aisling is a participator in, but not an employee of, Test Valley Ltd, a close trading company that prepares accounts to 31 December each year. Test Valley Ltd does not pay corporation tax by instalments.

In June 2021 the company loaned Aisling £72,000 for the purchase of a yacht. In January 2023 Aisling repaid £20,000 of her loan and in March 2024 the company waived the outstanding amount of the loan.

Aisling has taxable income of £80,000 p.a. but has not received any dividends in the tax year 2023/24.

Required:

Show the effect of these transactions on Test Valley Ltd and on Aisling.

(5 marks)

You should assume that the tax rates and allowances for the tax year 2023/24 apply throughout.



Bintou

Question 2

Bintou subscribes for 100,000 £1 shares in her family company, Grange Ltd, at par in November 1997. This represents a 25% holding in the company. Bintou is not an employee of Grange Ltd.

In August 2023 Bintou sells the shares back to the company at £7.30 per share, as she is aged 58 and ready to retire, and the family do not want the shares to go to outsiders.

Bintou has earned income of £160,000 in the tax year 2023/24 but has received no dividends and made no other capital disposals during the year. Grange Ltd is an unquoted trading company.

Required:

Advise Bintou of how the sale of shares will affect her tax liability for the tax year 2023/24 if:

- the transaction is treated as a distribution, and
- the transaction is not treated as a distribution.
- Explain the effect of satisfying the conditions for treatment as a capital event.

(6 marks)



Dulce

Question 3

Assume that today's date is 1 March 2023.

Dulce will resign from her job, in which she has been employed since 2007, earning a salary of £6,000 per month, on 31 March 2023.

Dulce intends to start trading on 1 April 2023 producing VAT exempt goods. Her business plan shows expected profits of £85,000 per annum net of wages to her employees. She is undecided whether she should incorporate or not as she does not understand the differences in the taxation of a sole trader and a company.

The business needs funds in the order of £100,000 to start up, but Dulce does not want to use her own capital.

She expects that funds will be easier to raise if she incorporates, but is confused about the taxation implications of equity versus loan finance.

Dulce estimates that she needs £20,000 per year to cover her living expenses, in addition to the £12,570 property income that she receives annually. Dulce has not made any pension provision to date.

She has no other employees.

Required:

- (a) Identify the main differences between the taxation of Dulce as a sole trader and the taxation of Dulce's company and Dulce as an employee and shareholder.

Calculate the income tax (IT), corporation tax (CT) and national insurance contributions (NIC) payable by Dulce and (where applicable) Dulce's company for the tax year 2023/24 or for the year ended 31 March 2024, under each of the following options:

- (i) Dulce trades as a sole trader,
- (ii) Dulce incorporates and takes a dividend of £21,822 as her only income from the company, and
- (iii) Dulce incorporates and takes a gross annual salary of £27,194 as her only income from the company.

Ignore the odd five days at the start of the accounting period

(i.e. assume that it matches the tax year 2023/24). **(8 marks)**

- (b) Describe the taxation implications of both equity and loan finance from the point of view of:

- (i) a company, and
- (ii) an individual investor.

(6 marks)

- (c) Assuming that Dulce decides to incorporate on 1 April 2023, taking an annual salary of £25,000 and annual dividends of £15,000, briefly describe the options available to Dulce for investing in a pension, the maximum contributions she could make during the tax year 2023/24, and how tax relief would be given. **(4 marks)**

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, scepticism and commercial acumen in your answer. **(4 marks)**

(Total: 22 marks)

25 Business Financial Management

There are no questions for this chapter.

26 VAT: outline



Ken and Cindy

Question 1

- (a) Ken has a market stall selling clocks and watches. He started trading on 1 March 2023, and his turnover has accrued evenly over time as follows:

	£
One month ended 31 March 2023	36,800
Quarter ended 30 June 2023	72,600
Quarter ended 30 September 2023	63,000
Quarter ended 31 December 2023	60,000

Required:

- (i) Advise Ken if he should register for VAT and, if so, when HMRC should be notified. **(3 marks)**
- (ii) Explain the impact on Ken's customers of Ken registering for VAT. **(2 marks)**
- (iii) Explain, with reasons, whether any of the VAT special accounting schemes would be suitable for Ken. **(6 marks)**

- (b) Cindy's input tax and supplies made in the quarter to 31 December 2023 are analysed as follows:

	£
Input tax wholly re-taxable supplies	25,575
Input tax wholly re-exempt supplies	15,400
Non-attributable input tax	30,800
Value (excluding VAT) of taxable supplies	275,000
Value of exempt supplies	120,000

Required:

Calculate the deductible input tax assuming that Cindy uses supplies for the current quarter for attributing input tax. **(3 marks)**

(Total: 14 marks)

27 VAT: administration and overseas aspects

There are no questions for this chapter.

28 Professional skills

There are no questions for this chapter.

29 Employability and technology skills

There are no questions for this chapter.

Test your understanding answers



Lowland Ltd

Answer 1 – Chapter 2

- (i) One set of accounts for the 18-month period to 30 June 2024
Lowland Ltd's 18-month period of account will be split into two accounting periods as follows:

	Year ended 31.12.2023	Period ended 30.6.2024
	£	£
Trading profits (W1)	292,667	146,333
Less: Capital allowances (W2)	(42,960)	(1,624)
	<u>249,707</u>	<u>144,709</u>
Property income (W3)	16,500	0
Chargeable gain (£46,000 – £28,000)	18,000	0
	<u>284,207</u>	<u>144,709</u>
TTP	284,207	144,709
Plus: Dividend received	13,750	
	<u>297,957</u>	<u>144,709</u>
Augmented profits	297,957	144,709
Corporation tax (W4)		
FY2022 ($£284,207 \times 19\% \times 3/12$)	13,500	
FY2023 ($£284,207 \times 25\% \times 9/12$)	53,289	
FY2023 ($£144,709 \times 25\%$)		36,177
	<u>66,789</u>	<u>36,177</u>
Due date (W5)	1 Oct 2024	1 Apr 2025
Total liability (£66,789 + £36,177)		<u>£102,966</u>

(ii) **Preparing separate accounts for the six-month period to 30 June 2023 and for the year ended 30 June 2024**

	Period ended 30.6.2023 £	Year ended 30.6.2024 £
Trading profits (W6)	155,000	284,000
Less: Capital allowances (W7)	(40,980)	(3,604)
	<hr/> 114,020	<hr/> 280,396
Property income/(loss) (W8)	26,500	(10,000)
Chargeable gain (see note below)	46,000	0
	<hr/> 186,520	<hr/> 270,396
TTP	186,520	270,396
Plus: Dividend received		13,750
	<hr/> 186,520	<hr/> 284,146
Augmented profits	<hr/> 186,520	<hr/> 284,146
Corporation tax (W9)		
FY2022 ($£186,520 \times 19\% \times 3/6$)	17,719	
FY2023 ($£186,520 \times 25\% \times 3/6$)	23,315	
FY2023 ($£270,396 \times 25\%$)		67,599
	<hr/> 41,034	<hr/> 67,599
Due date (W10)	1 Apr 2024	1 Apr 2025
Total liability ($£41,034 + £67,599$)	<hr/> £108,633	

Note: The capital loss occurs in the y/e 30 June 2024. It can only be carried forward and set against future chargeable gains.

Conclusion

Preparing one set of accounts for the 18-month period to 30 June 2024 appears to be beneficial, as it results in an overall tax saving of £5,667 ($£108,633 - £102,966$).

It also results in a later due date for some of the corporation tax liability (1 October 2024 compared to 1 April 2024).

Workings

(W1) Trading profits – 18-month accounts

	£
Total trading profits	
(£155,000 + £139,000 + £145,000)	439,000
Year ended 31 December 2023 ($£439,000 \times 12/18$)	292,667
Period ended 30 June 2024 ($£439,000 \times 6/18$)	146,333

(W2) Capital allowances – 18-month accounts

	AIA	Pool	Allowances
	£	£	£
Y/e 31 December 2023			
TWDV b/f		22,000	
Addition qualifying for AIA			
30 April 2023	39,000		
AIA	(39,000)		39,000
		0	
		22,000	
WDA ($18\% \times £22,000$)		(3,960)	3,960
		18,040	
TWDV c/f			
Total allowances			42,960
P/e 30 June 2024			
WDA ($18\% \times 6/12$)		(1,624)	1,624
TWDV c/f		16,416	

(W3) Property income – 18-month accounts

Year ended 31 December 2023	£
Reading – rental income ($£53,000 \times 6/12$)	26,500
Guildford – allowable loss	(10,000)
	<hr/>
Property income assessment	16,500
	<hr/>

The cost of decorating the Guildford building is allowable on 'business' expense principles. The allowable loss is automatically set off against the rental income from the Reading building as all lettings are treated as a single business.

(W4) Rate of corporation tax – 18-month accounts

Year ended 31 December 2023	
FY2022	19%
FY2023 (augmented profits above upper limit)	25%
Period ended 30 June 2024	
FY2023 (assume rates continue)	25%

Limits are time apportioned for the length of the AP:

$$(£50,000 \times 6/12) = £25,000$$

$$(£250,000 \times 6/12) = £125,000$$

Augmented profits are above the upper limit.

(W5) Corporation tax due dates – 18-month accounts

Year ended 31 December 2023:

Augmented profits are below the threshold of £1,500,000

Period ended 30 June 2024

The threshold is applied pro rata for the length of the accounting period:

$$(£1,500,000 \times 6/12) = £750,000$$

Augmented profits are still below the threshold.

Therefore, for both periods, tax is due nine months and one day after the end of the AP.

(W6) Trading profits – Separate accounts

	£
Period ended 30 June 2023	155,000
Year ended 30 June 2024 (£139,000 + £145,000)	284,000

(W7) Capital allowances – Separate accounts

P/e 30 June 2023	AIA £	Pool £	Allowances £
TWDV b/f		22,000	
Addition qualifying for AIA			
30 April 2023	39,000		
AIA	(39,000)		39,000
(Max £1,000,000 × 6/12)			
		0	
		22,000	
WDA (18% × 6/12)		(1,980)	1,980
		20,020	
			40,980
Y/e 30 June 2024			
WDA (18%)		(3,604)	3,604
		16,416	

(W8) Property loss – Separate accounts

The cost of decorating the Guildford building is allowable on 'business' expense principles.

The allowable loss is automatically set off against Lowland Ltd's other income for the year ended 30 June 2024.

(W9) Rate of corporation tax – Separate accounts

Period ended 30 June 2023

FY2022 19%

FY2023 25%

The limits are time apportioned for the length of the AP:

$(£50,000 \times 6/12) = £25,000$

$(£250,000 \times 6/12) = £125,000$

Augmented profits are above the upper limit.

Year ended 30 June 2024

FY2023 (assume rates continue) 25%

Augmented profits are above the upper limit.

(W10) Corporation tax due dates – Separate accounts

Six months to 30 June 2023

The threshold = $(£1,500,000 \times 6/12) = £750,000$ The augmented profits are less than £750,000.

Year ended 30 June 2024

For the year ended 30 June 2024 the augmented profits are less than £1,500,000.

Therefore, for both periods, corporation tax is due nine months and one day after the end of the AP.

**Cosmet Ltd****Answer 1 – Chapter 3****(a) (i) Taxable total profits**

	y/e 31.5.2021	y/e 31.5.2022	p/e 31.12.2022	y/e 31.12.2023
	£	£	£	£
Trading profit	750,250	500,500	101,999	0
Property income	10,000	10,000	10,000	11,000
Bank interest	8,460	7,526	5,076	5,275
Net chargeable gains (W)	1,622	0	0	59,390
	<hr/>	<hr/>	<hr/>	<hr/>
	770,332	518,026	117,075	75,665
Less: Loss relief	0	(40,050)	(117,075)	(75,665)
	<hr/>	<hr/>	<hr/>	<hr/>
TTP	770,332	477,976	0	0
	<hr/>	<hr/>	<hr/>	<hr/>

Loss memorandum

	£
Loss for y/e 31 December 2023	232,790
Less: Loss relief:	
Current period claim: y/e 31 December 2023	(75,665)
Carry back 12 months:	
7 m/e 31 December 2022	(117,075)
y/e 31 May 2022	
(max £518,026 × 5/12 = £215,844)	
restricted to amount of loss left	(40,050)
	<hr/>
Loss available to carry forward	0
	<hr/>
(ii) Tax repayments:	
P/e 31 December 2022 (FY2022)	
(19% × £117,075)	£22,244
	<hr/>
Y/e 31 May 2022 (FY2021 and FY2022)	
(19% × £40,050)	£7,610
	<hr/>

Working: Net chargeable gains

y/e 31 May 2022	Capital loss to carry forward £4,000
p/e 31 December 2022	Net chargeable gain
	= (£2,990 – £2,990 capital loss b/f) = £Nil
	Capital loss remaining to c/f
	= (£4,000 – £2,990) = £1,010
y/e 31 December 2023	Net chargeable gain
	= (£60,400 – £1,010 capital loss b/f)
	= £59,390

(b) Notes for meeting

(1) Merging with another company

- There are anti-avoidance provisions that restrict the carry forward of trading losses when there is both a change in the ownership and a major change in the nature and conduct of trade within a five-year period.
- The five-year period can begin up to three years before the change of ownership.

- Trading losses arising before the change in ownership cannot be carried forward to periods after the change, nor can losses arising after a change in ownership be carried back to periods before the change.
 - A change in ownership means that more than one half of the ordinary share capital of the company is acquired by a person or persons, ignoring any person acquiring 5% or less.
 - A major change in the nature or conduct of the trade includes:
 - a major change in the type of property dealt in or services provided; and
 - a major change in customers, outlets or markets.
- (2) **Changing the products and trading in a more lucrative market**
- Carry forward relief is available against future total profits, as long as the trade does not cease.
 - Changing the products made should not prevent relief for losses in the future.



Longbow Ltd

Answer 1 – Chapter 4

(a) **One-third of Minnow Ltd's share capital acquired**

Minnow Ltd	£
Chargeable gain	50,000
Less: Loss relief	(50,000)
	<hr/>
TTP	0
	<hr/>

Longbow Ltd	£
Trading profit	220,000
Interest income (£150,000 @ 7% × 8/12)	7,000
	<hr/>
	227,000
Less: Consortium relief	
(£140,000 – £50,000) = £90,000 × 1/3 × 6/12	(15,000)
	<hr/>
TTP	212,000
	<hr/>
Corporation tax (£212,000 × 25%)	53,000
Less: Marginal relief	
(£250,000 – £212,000) × 3/200	(570)
	<hr/>
Corporation tax liability	52,430
	<hr/>

Note:

- (1) Minnow Ltd is a consortium company, and one-third of its trading loss can therefore be surrendered to Longbow Ltd. Minnow Ltd must consider its own current year profits when calculating the loss to surrender, and this is restricted to the overlapping period of 1 October 2023 to 31 March 2024.
- (2) Minnow Ltd's trading loss not used in y/e 31 March 2024 of £75,000 (£140,000 – £50,000 – £15,000) will be carried forward against future total profits arising in Minnow Ltd.

(b) Two-thirds of Minnow Ltd's share capital acquired

Minnow Ltd

The company's TTP will be the same as above.

Longbow Ltd	£
Trading profit	220,000
Interest income	7,000
	<hr/>
	227,000
Less: Consortium relief	
(£140,000 – £50,000 = £90,000 × 2/3 × 6/12)	(30,000)
	<hr/>
TTP	197,000
	<hr/>
Corporation tax liability (£197,000 × 25%)	49,250
	<hr/>

Note:

- (1) Minnow Ltd is an associated company, and so the limits for corporation tax are reduced to £125,000 (£250,000/2) and £25,000 (£50,000/2).
- (2) The remaining loss of £60,000 will be carried forward in Minnow Ltd for use against future total profits subject to no major change in the nature and conduct of trade following the change in ownership.

(c) All of Minnow Ltd's share capital acquired**Minnow Ltd**

	£
Chargeable gain (Note 2)	12,500
Less: Loss relief	(12,500)
	<hr/>
TTP	0

Longbow Ltd

	£
Trading profit	220,000
Interest income	7,000
	<hr/>
	227,000
Less: Group relief (£140,000 × 6/12)	(70,000)
	<hr/>
TTP	157,000
	<hr/>
Corporation tax liability (£157,000 × 25%)	39,250
	<hr/>

Notes:

- (1) Minnow Ltd is a 75% subsidiary.
- (2) Rollover relief could be claimed based on the freehold factory to be purchased by Longbow Ltd as Minnow Ltd and Longbow Ltd are now in the same capital gains group.

As all of the sale proceeds relating to the business use is reinvested (i.e. £120,000 > 75% × £150,000 = £112,500), all of the business proportion of the gain can be rolled over.

The gain rolled over would be £37,500 (75% × £50,000).
 Chargeable gain = (£50,000 – £37,500) = £12,500.

A rollover claim is likely to be beneficial, as the deferred gain is only chargeable when Longbow Ltd sells the new asset, and may be rolled over again if further reinvestment is made in qualifying assets.

Relief for the trading loss carried forward in Minnow Ltd will be against future total profits arising in Minnow Ltd, subject to no major change in the nature and conduct of trade following the change in ownership.

An alternative to the rollover claim would be to leave the £50,000 gain chargeable in Minnow Ltd and offset £50,000 of Minnow Ltd's trading losses against it in the current year. This would leave a smaller loss to carry forward in Minnow Ltd, and may avoid a higher tax charge on the deferred gain in future when there may not be losses available to set against it.

Assuming the rollover claim is made, the trade loss to carry forward in Minnow Ltd will be:

	£
Trading loss arising y/e 31 March 2024	140,000
Less: Group relief	(70,000)
Less: Current year offset	(12,500)
	<hr/>
Available to c/f	57,500
	<hr/>

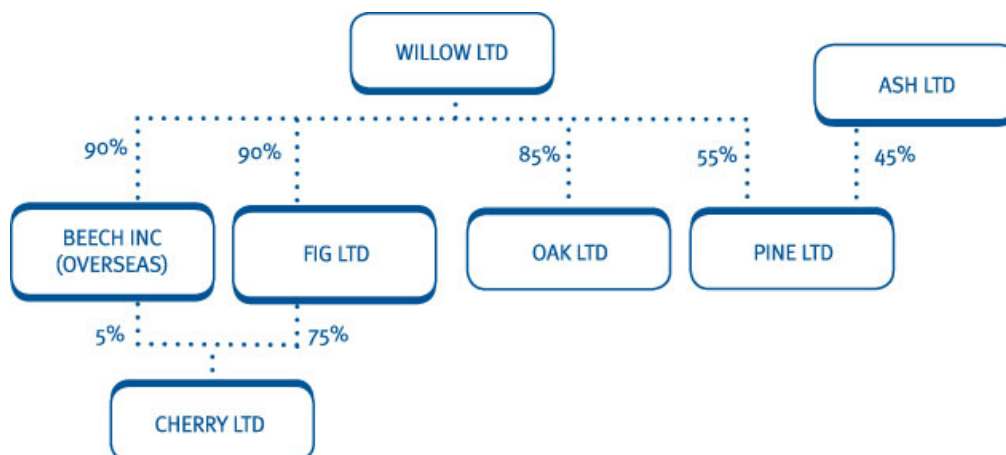


Willow Group

Answer 2 – Chapter 4

Corporation tax computations – y/e 31 March 2024

	Ash Ltd £	Pine Ltd £	Willow Ltd £	Oak Ltd £	Fig Ltd £	Cherry Ltd £
Trading profits	0	158,000	40,000	0	294,000	0
Consortium relief (W3)		(71,100)				
Group relief (W2)			(31,667)		(15,000)	
					(75,333)	
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
TTP	0	86,900	8,333	0	203,667	0
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Corporation tax @ 25%		21,725			50,917	
@ 19%			1,583			
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Corporation tax	0	21,725	1,583	0	50,917	0
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

Workings**(W1) Analysis of group structure**

Number of associated companies = 6

Upper limit = £250,000/6 = £41,667

Lower limit = £50,000/6 = £8,333

75% groups

Group 1 = Willow Ltd, Beech Inc, Fig Ltd, Oak Ltd (but Beech Inc is an overseas company and cannot surrender its losses to the UK)

Group 2 = Fig Ltd, Cherry Ltd

Consortium members = Ash Ltd, Willow Ltd

Consortium owned company = Pine Ltd

(W2) Losses working

Deal with the most restricted losses first:

(i) Consortium relief Ash Ltd can only give its loss to Pine Ltd

(ii) Group relief Cherry Ltd can only give its loss to Fig Ltd

(iii) Group relief Oak Ltd can give its loss to Fig Ltd and Willow Ltd

Aim of loss relief: to use as much loss as possible and to save tax at the highest marginal rate, by bringing the companies in the group down to the lower profit limit.

Therefore, Cherry Ltd will give its loss to Fig Ltd.

Oak Ltd will then surrender its loss to Willow Ltd first to reduce its profits down to £8,333 and save tax at 26.5%, then give the rest to Fig Ltd to save tax at 25%.

Note: Beech Inc is an overseas company and cannot surrender its losses to the UK.

	Ash Ltd	Oak Ltd	Cherry Ltd
	£	£	£
Loss in the year	160,000	107,000	15,000
Consortium relief to Pine Ltd (W3)	(71,100)		
Group relief to Fig Ltd			(15,000)
Group relief to Willow Ltd		(31,667)	
Group relief to Fig Ltd		(75,333)	
Loss to carry forward	88,900	0	0

(W3) Consortium relief

Lower of:		£
1 Available loss of Ash Ltd		160,000
2 Percentage of Pine Ltd's TTP/(loss) (45% × £158,000)		71,100



North and South

Answer 3 – Chapter 4

(a) Corporation tax computations

North Ltd

Year ended 31 March	2024	2025
	£	£
Trading profit	10,000	
Chargeable gain (£120,000 – £80,000)		40,000
Less: Loss relief – current year – carried back	(10,000)	(40,000)
TTP	0	0
Corporation tax liability	0	0

Loss working:	£
Loss per question	(114,000)
Less: Profit on sale of inventory (£10,000 – £6,000)	4,000
	<hr/>
Revised loss	(110,000)
Current year offset	40,000
Carry back relief	10,000
	<hr/>
Carried forward as at 31 March 2025	(60,000)
	<hr/>

South Ltd

Year ended 31 March	2024	2025
	£	£
Trading profit = TTP	160,000	200,000
	<hr/>	<hr/>
	£	£
Corporation tax liability @ 25%:	40,000	50,000
	<hr/>	<hr/>

North Ltd and South Ltd are associated as they are under common control, so the limits for corporation tax will be £125,000 (£250,000/2) and £25,000 (£50,000/2).

Total corporation tax payable by North Ltd and South Ltd is therefore £90,000 (£40,000 + £50,000).

(b) Weaknesses of the group structure

North Ltd and South Ltd are owned personally by Bertrand and do not therefore form a 75% group for both group relief and chargeable gains purposes.

As a consequence:

- (i) The forecast trading losses of North Ltd for the y/e 31 March 2025 cannot be relieved against the profits made by South Ltd for this accounting period.
- (ii) The group rollover relief provisions are not available. As a result, North Ltd is unable to relieve its gain of £40,000 by rolling this (at least partially) into the proposed acquisition of the freehold property by South Ltd in the y/e 31 March 2025.

Improvement of group structure

To improve the group structure a 75% relationship therefore needs to be established for North Ltd and South Ltd. This could be achieved either by placing North Ltd and South Ltd beneath a holding company or (more simply) by placing North Ltd beneath South Ltd (or vice versa).

This would enable North Ltd's losses for the y/e 31 March 2025 to be surrendered to South Ltd, and would also enable part of North Ltd's chargeable gain to be deferred by claiming rollover relief against the purchase of South Ltd's property.

(c) Revised corporation tax computations

North Ltd

Year ended 31 March	2024	2025
	£	£
Trading profit	10,000	0
Chargeable gain (Note 1)		20,000
	<hr/>	<hr/>
TTP	10,000	20,000
	<hr/>	<hr/>
Corporation tax @ 19%	1,900	3,800
	<hr/>	<hr/>
Loss working		£
Loss per question		(114,000)
Less: Profit on inventory		4,000
		<hr/>
Revised loss		(110,000)
Group relief (Note 2)		110,000
		<hr/>
Carried forward as at 31 March 2025		0
		<hr/>

South Ltd

Year ended 31 March	2024 £	2025 £
Trading profit	160,000	200,000
Group relief (Note 2)		(110,000)
	<hr/>	<hr/>
TTP	160,000	90,000
	<hr/>	<hr/>
Corporation tax (as before)/($£90,000 \times 25\%$)	40,000	22,500
Less: Marginal relief ($£125,000 - £90,000) \times 3/200$)		(525)
	<hr/>	<hr/>
Corporation tax liability	40,000	21,975
	<hr/>	<hr/>

Total corporation tax payable by North Ltd and South Ltd is therefore £67,675 (£1,900 + £3,800 + £40,000 + £21,975), a saving of £22,325 (£90,000 – £67,675).

Notes:

- (1) Group rollover relief will be available as follows:

	£
Original gain on freehold property	40,000
Less: Rollover relief (balancing figure)	(20,000)
	<hr/>
Taxable now = proceeds not reinvested ($£120,000 - £100,000$)	20,000
	<hr/>

- (2) South Ltd pays tax at the main rate of 25% but North Ltd only pays tax at the small profits rate of 19%.

In order to minimise the tax liability of the group, the loss of North Ltd can be surrendered to South Ltd.

This will bring South Ltd into the marginal band, saving some tax at 26.5%.

The rates of tax saved will be as follows:

	£	
South Ltd profits above upper limit ($£200,000 - £125,000$)	75,000	at 25%
South Ltd profits between the limits ($£110,000 - £75,000$)	35,000	at 26.5%
	<hr/>	
Total loss surrendered	110,000	
	<hr/>	

Note: Bringing South Ltd into the marginal band will not increase its overall corporation tax liability. It is only the profits between the limits that are effectively taxed at 26.5%; the **average** rate of tax paid by a marginal company will be between 19% and 25%.



Bertie Overseas

Answer 1 – Chapter 5

Client Address

Firm address

Date

Dear Bertie,

Re: Overseas Expansion

Further to our recent meeting I am writing to set out the principal business tax issues regarding the setting up of Bertie Overseas in the country of Picea.

These would appear to be as follows:

- The basis of taxation of overseas profits and relief for overseas losses.
- Whether Bertie Overseas should take the form of an overseas branch or a limited company.
- Whether relief can be obtained in the UK for any overseas taxes paid.
- Whether there is any relevant anti-avoidance legislation which may apply.

Dealing with each of these in turn.

Basis of taxation and the branch v limited company decision

Subject to the anti-avoidance measures detailed below, when Bertie Overseas starts making profits the 'usual' rules are as follows:

If Bertie Overseas takes the form of a non-UK resident limited company, then dividends payable to Bertie Ltd will not be taxable in the UK.

This will be beneficial as corporate taxes in Picea are only 10%.

On the other hand, if Bertie Overseas is set up as an overseas branch of Bertie Ltd, which is controlled from the UK, the automatic position is that all of the overseas profits generated (whether or not they are remitted to the UK) will be treated as part of the profits of Bertie Ltd and therefore entirely taxable in the UK. In these circumstances, however, the vehicles and equipment acquired will qualify for UK capital allowances. In addition, any premises constructed on or after 29 October 2018 would qualify for structures and buildings allowances (SBAs) if used in the trade of the branch.

Alternatively, it is possible for Bertie Ltd to make an irrevocable election to exempt the profits of overseas permanent establishments. If this election is made, the overseas branch profits will not be taxable in the UK so there will be very little difference between the tax treatment of the branch compared to the non-UK resident limited company.

However, if the election is made then there will be no relief for losses in the UK, and no UK capital allowances (including SBAs) may be claimed.

It should be noted that these rules could be used to your advantage.

Your business plan anticipates that Bertie Overseas will make a loss in its first year of operation which will then be followed by progressively stronger profits.

If Bertie Overseas takes the form of a non-UK resident limited company in year one, then Bertie Ltd will not be able to offset the losses generated against its own profits. The use of these losses will therefore be determined by Picean tax law. It is stated that Picea has no facility to carry losses backwards or forwards and presumably therefore these losses would remain unrelieved.

If, however, Bertie Overseas takes the form of an overseas branch this is effectively regarded by UK tax law as an extension of the UK trade. Any overseas losses generated are likely therefore to be automatically offset against UK source profits generated by Bertie Ltd. As Bertie Ltd is a successful company, it seems probable that these will therefore all be relieved as incurred.

This would only be of benefit in year one of the overseas operations. To prevent 100% of eventual overseas profits being taxed in the UK after year one the overseas branch could then be incorporated as a non-UK resident limited company, or the election to exempt the profits of overseas permanent establishments could then be made.

Relief for overseas taxes paid on branch profits

To prevent the taxation of overseas income twice (once in the UK and once in the overseas territory) UK legislation allows for double tax relief.

In the absence of a double tax treaty this works by allowing any Picean corporation tax paid on branch profits from Bertie Overseas to be credited against Bertie Ltd's UK corporation tax.

Double tax relief is, however, restricted to the lower of the overseas corporation tax paid and the UK corporation tax on the taxable profits from the overseas source.

As Picean corporation tax rates are 10% which is lower than the rate of UK corporation tax currently being paid (i.e. 25%), all of the Picean tax should be available as a credit against Bertie Ltd's corporation tax liability.

Anti-avoidance legislation

The fact that the use of an overseas subsidiary paying dividends allows companies to avoid UK corporation tax on remittances to the UK is of concern to HMRC. As a result, a variety of anti-avoidance legislation exists to protect the UK Treasury position.

The principal pieces of such legislation are as follows:

Transfer pricing

In circumstances where sales are made by a UK resident company to another company (resident in a country that is a non-qualifying territory) which it controls, at an undervalue (thus depressing UK profits), HMRC can substitute a market value price. This is known as transfer pricing.

As Picea does not have a double tax treaty with the UK then this would make it a non-qualifying territory for the purposes of the transfer pricing legislation. This means that regardless of the size of Bertie Ltd the transfer pricing legislation will apply as Bertie Overseas is resident in a non-qualifying territory.

The legislation is applicable because the proposed mark up to Bertie Overseas is lower than HMRC might expect (80% compared to 85%). We are aware that Bertie Overseas will be responsible for all of its sale and distribution costs therefore it may be possible to explain the reduction in mark up if Bertie Overseas is required to undertake further responsibilities. This is an area that can be further explored at our next meeting.

It is likely that a transfer pricing liability may also exist relating to the differential in interest rates that will be charged of 2%.

Bertie Ltd must self-assess its liability under transfer pricing within its corporation tax return. Penalties can be levied if HMRC are successful in arguing that adjustments should have been made but were not.

For this reason, it is recommended that Bertie Ltd sets out in advance its proposed transfer pricing arrangements to HMRC under a statutory procedure known as Advance Pricing Arrangements and negotiate their acceptance with them.

Residence status of overseas limited company

The exemption from the UK corporation tax will only apply to dividends received from non-UK resident companies. If HMRC can successfully argue that Bertie Overseas is in fact UK resident, then all of its profits will be subject to UK corporation tax (with double tax relief available for tax paid in Picea).

A company will be UK resident if it is incorporated in the UK or it is centrally managed and controlled from the UK. Clearly the former is not a problem but the latter may be. This is because the test is not where day to day control is exercised but rather the highest level of strategic control. If this is exercised by the UK board of Bertie Ltd it is likely that HMRC will regard control as being UK based thus making Bertie Overseas UK resident.

This is something that will need to be explored in greater depth when we next meet.

Controlled foreign company

In certain circumstances HMRC have powers to apportion profits of controlled foreign companies ('CFC') to a UK resident company.

A CFC exists where a foreign company under UK control is resident in a low tax area (tax is less than 75% of UK corporation tax that would be payable) and is set up with a view to avoid UK tax.

On the face of it, it would appear that Bertie Overseas will be caught by this legislation but this is considered unlikely as various exemptions exist.

In the short term, Bertie Overseas will be covered by the low profits exemption. This applies if the overseas company's TTP is £500,000 or less in a 12-month period, of which no more than £50,000 comprises non-trading profits.

Even if profits increase above this level, trading profits of the CFC will only fall within the charge to the extent that the profits are dependent on an activity provided from the UK which the CFC would be incapable of doing for itself, and the profits are only arising in the CFC for the purpose of avoiding UK tax.

This does not seem to be the case, as Bertie Overseas is considered to have a genuine commercial presence in Picea, and is therefore not considered further.

I hope the above adequately summarises the position but should you have any queries please do not hesitate to contact me.

Meanwhile I look forward to hearing from you further in the near future.

Yours sincerely,

A Accountant



Oti

Answer 1 – Chapter 6

Capital gains tax – 2023/24

	£
Table (W1)	3,750
Car (Exempt asset)	0
Property (W2)	322,225
Business asset (W3)	33,000
Less: AEA	(6,000)
	<hr/>
Total net chargeable gains	352,975
Less: Capital loss b/f	(8,950)
	<hr/>
Taxable gains	344,025
	<hr/>
Capital gains tax liability (£344,025 × 20%)	68,805
	<hr/>

Note: Capital losses b/f are offset against the capital gains in 2023/24.

Net cash received from sale of assets

Proceeds received:

	£
Table	12,500
Car	8,700
Property (£485,000 – £4,075)	480,925
Business asset	37,000
Less: CGT payable	(68,805)
	<hr/>
Net cash received	470,320
	<hr/>

Workings**(W1) Table**

	£
Sale proceeds	12,500
Less: Cost	(8,750)
	<hr/>
Chargeable gain	3,750
	<hr/>

(W2) Property

	£
Sale proceeds	485,000
Less: Costs of sale	(4,075)
	<hr/>
Net sale proceeds	480,925
Less: Cost	(156,000)
Costs of acquisition	(2,700)
	<hr/>
Chargeable gain	322,225
	<hr/>

(W3) Business asset

	£
Sale proceeds	37,000
Less: Cost	(4,000)
	<hr/>
Chargeable gain	33,000
	<hr/>

The asset does not qualify for business asset disposal relief as it is not part of the sale of the whole of the business.



Dante

Answer 1 – Chapter 7

(a) Capital gains tax – 2023/24

		£
Greyhound (W1)		0
Lease (W3)		87,954
Painting (W5)		41,000
Ring (exempt)(W6)		0
Land (W7)		96,667
Less: Capital loss (W2)		(1,500)
		<hr/>
Total chargeable gains		224,121
Less: AEA		(6,000)
		<hr/>
Taxable gains		218,121
	£	
Basic rate (W9)	$18,650 \times 10\%$	1,865
Higher rate	$199,471 \times 20\%$	39,894
	<hr/>	
	218,121	
	<hr/>	
Capital gains tax liability		<hr/> 41,759
Due date for payment		31 January 2025

Workings

(W1) Greyhound

A greyhound is a wasting chattel which is exempt from CGT.

(W2) Unquoted shares

	£
Proceeds	6,000
Less: Probate value	(7,500)
	<hr/>
Allowable loss	(1,500)
	<hr/>

(W3) Short lease

	£
Proceeds	275,000
Less: Deemed cost (W4)	(187,046)
	<hr/>
Chargeable gain	87,954
	<hr/>

Business asset disposal relief is not available as this is not a disposal of the entire business.

(W4) Deemed lease cost

Years left to run at acquisition	39 years	12.02.16
Years left to run at disposal	31 years 4 months	19.10.23

The percentage for 31 years 4 months is

$$88.371 + ((89.354 - 88.371) \times 4/12) = 88.699$$

The allowable cost to deduct in the computation is therefore deemed to be:

(% for life of the lease left on disposal date ÷ % for life of the lease left on acquisition date) × Cost

$$= (88.699 (\% \text{ for 31 years 4 months}) \div 94.842$$

$$(\% \text{ for 39 years})) \times £200,000$$

$$= £187,046$$

(W5) Painting

	£
Proceeds	50,000
Less: Cost	(9,000)
	<hr/>
Chargeable gain	41,000
	<hr/>

(W6) Antique ring

The antique ring is a chattel. As it was sold for less than £6,000, and cost less than £6,000, the gain is exempt.

(W7) Remaining interest in land

	£
Proceeds	205,000
Less: Deemed cost (W8)	(108,333)
	<hr/>
Chargeable gain	96,667
	<hr/>

(W8) Deemed cost of part disposal

Disposal in June 2020 – Deemed cost	
Cost (2 hectares of 10 hectares)	
= cost × (A/(A + B))	
= £130,000 × (£30,000/£30,000 + £150,000)	£21,667
	<hr/>
Disposal on 28 March 2024 – Deemed cost	
(£130,000 – £21,667)	£108,333
	<hr/>

(W9) Remaining basic rate band

	£	£
Basic rate band		37,700
Add: Gross PPCs (£4,000 × 100/80)		5,000
		<hr/>
Extended basic rate band		42,700
Employment income	36,620	
Less: PA	(12,570)	
	<hr/>	
Taxable income		(24,050)
		<hr/>
Remaining basic rate band for CGT purposes		18,650
		<hr/>

(b) Effect of delaying the sale of the plot of land

If the sale of the land took place on 6 April 2024, the gain of £96,667 would not be taxed until the tax year 2024/25.

This would save CGT, as a further AEA would be available to match against this gain, and part of the gain would now fall into Dante's remaining basic rate band and be taxed at 10% instead of 20% (this assumes Dante's income remains unchanged).

The tax saved would be as follows:

	£
Saving from AEA (£6,000 × 20%)	1,200
Part of gain now in BR band (£18,650 × (20% – 10%))	1,865
	<hr/>
Total tax saved by delaying sale	3,065
	<hr/>

In addition, the tax payable on the gain on disposal of land would not be due until 31 January 2026, which would represent a cash flow benefit to Dante.



Emma

Answer 1 – Chapter 8

Capital gains tax – 2023/24

	£
Apple plc shares (W1)	74,000
Willow Ltd shares (W2)	49,700
NS certificates (Exempt)	0
Bridge plc takeover (W3)	26,950
	<hr/>
Total chargeable gains	150,650
Less: AEA	(6,000)
	<hr/>
Taxable gains	144,650
	<hr/>
Capital gains tax liability (£144,650 × 20%)	28,930
	<hr/>

Workings

(W1) Shares in Apple plc

Share pool	Number	Cost £
March 2019: Purchase	400	10,000
January 2020: Rights issue 1:4 @ £30 per share	100	3,000
December 2021: Purchase	200	8,000
January 2023: Bonus issue 1:2	350	0
	<hr/>	<hr/>
	1,050	21,000
Disposal	(1,050)	(21,000)
	<hr/>	<hr/>
Balance to c/f	0	0
	<hr/>	<hr/>
		£
Disposal proceeds		95,000
Less: Cost		(21,000)
		<hr/>
Chargeable gain		74,000
		<hr/>

(W2) Willow Ltd

		£
Proceeds		50,000
Less: Cost (see below)		(300)
		<hr/>
Chargeable gain		49,700
		<hr/>
Share Pool	Number	Cost
		£
Purchase	10	1,000
Disposal	(3)	(300)
	<hr/>	<hr/>
Balance c/f	7	700
	<hr/>	<hr/>

(W3) Bridge plc takeover

For 100 Bridge plc shares:	January 2024
	£
Loan notes in Poker plc (100 × £50)	5,000
Cash (100 × £350)	35,000
	<hr/>
Consideration received	40,000
	<hr/>

The loan notes are qualifying corporate bonds (QCBs).

Where a QCB is received in exchange for shares, the gain attributable to these shares is computed as if the bond were cash and this gain is frozen until the corporate bond is disposed of at a later date.

The only gain chargeable in the tax year 2023/24 is the gain attributable to the cash received.

The cash consideration is not small and therefore the part disposal rules apply.

Allocation of cost:		£
Loan notes	(£9,200 × 5,000/40,000)	1,150
Cash consideration	(£9,200 × 35,000/40,000)	8,050
		<hr/>
		9,200
		<hr/>

Gain re cash consideration:

	£
Cash proceeds	35,000
Less: Deemed cost (above)	(8,050)
	<hr/>
Chargeable gain	26,950
	<hr/>



Harry and Celine

Answer 1 – Chapter 9

(a) Capital gains tax – 2023/24

With gift holdover relief claim	£
X Ltd shares (W1)	42,143
House (W3)	0
	<hr/>
Total chargeable gains	42,143
Less: AEA	(6,000)
	<hr/>
Taxable gains qualifying for BADR	36,143
	<hr/>
Capital gains tax (£36,143 × 10%)	3,614
	<hr/>
Without gift holdover relief claim	£
X Ltd shares (W1)	295,000
House (W3)	0
	<hr/>
Total chargeable gains	295,000
Less: AEA	(6,000)
	<hr/>
Taxable gains qualifying for BADR	289,000
	<hr/>
Capital gains tax (£289,000 × 10%)	28,900
	<hr/>

The decision to claim gift holdover relief depends on the intention of Harry's daughter in the future.

On the subsequent disposal of the shares by the daughter she will be entitled to BADR provided she satisfies the conditions. Harry and his daughter will therefore benefit from both gift holdover relief and BADR.

If, however, she does not intend to own the shares for at least two years and/or not work for the company, BADR will not be available to her. In this case it would be beneficial for Harry and his daughter not to claim gift holdover relief on the original gift as (assuming the capital gains tax rates remain unchanged) she will be liable to tax at 20% on the gain, but Harry would only be liable at a rate of 10% on the gain arising now.

(b) Notes for meeting with Celine

- Rollover relief (ROR) may be available to Celine.
- This means that she can make a claim to defer the gain on the building she sold to X Ltd in April 2023, against the base cost of the new commercial property.
- As a result, she will
 - obtain a repayment of the CGT paid in respect of the building, and
 - defer the gain until the new commercial property is sold.
- However, conditions must be satisfied to obtain the relief.
- Celine has disposed of a freehold property which is a qualifying business asset (QBA) for ROR purposes.
- The replacement commercial building can be either freehold or leasehold, but must be occupied and used for trading purposes.
- The replacement property must be acquired before 1 April 2026 (i.e. within the four-year qualifying period beginning one year before, and ending three years after the date of sale of the old asset).
- A claim needs to be made for ROR by the later of 5 April 2027 (i.e. within four years from the end of the tax year in which the disposal occurred (2022/23 disposal), or four years from the end of the tax year in which the replacement is acquired).
- If all of the proceeds from the sale of the old asset are reinvested, full ROR is available (i.e. all of the gain is deferred).

However, where there is partial reinvestment of the proceeds only part of the gain may be deferred.

- Celine could plan her reinvestment to ensure that a ROR claim will leave a gain to be taxed which utilises her capital losses and the AEA.
- If the new commercial property is a leasehold interest in land and buildings with 60 years or less to run on the lease, the gain will be taxable ten years after the date of acquisition of the leasehold property or earlier if the replacement building is sold or ceases to be used in the trade before then.
- Adjustments need to be made to the calculation of the amount of deferral relief available if there is an element of non-business use.

- BADR would be available on any remaining gain on the sale of the building to X Ltd in the tax year 2022/23. This is because Celine sold the building when she ceased trading, and as long as the building was sold within three years of cessation the relief is available. However, if Celine had carried on trading there would be no BADR as the disposal was the sale of a single asset.

Workings

(W1) X Ltd shares

	£
Market value	365,000
Less: Cost	(70,000)
	<hr/>
Capital gain before reliefs	295,000
Less: Gift holdover relief (W2)	(252,857)
	<hr/>
Gain qualifying for BADR	42,143
	<hr/>

BADR is available as Harry is disposing of a shareholding in a personal trading company in which he has held at least 5% and has been an employee for the two years prior to disposal. The relief is not restricted for investments in the company accounts.

If Harry and his daughter do not claim gift holdover relief then Harry will have the following capital gain:

	£
Capital gain qualifying for BADR	295,000
	<hr/>

(W2) Gift holdover relief

Proportion of gain eligible for gift holdover relief
 $= (\text{MV of total CBA} / \text{MV of total CA}) \times £295,000$
 $= [£480,000 / (£480,000 + £80,000)] \times £295,000 = £252,857$

(W3) Private residence

The sale of the home is fully covered by private residence relief (PRR).

Although Harry did not live in the house for one year, any period or periods which together do not total more than three years is exempt under the PRR rules provided the property was owner occupied at some time both before and after the period of absence.



Alwyn

Answer 1 – Chapter 11

	CLT 4.7.2012 £	PET 4.3.2017 £	PET 4.3.2017 £	CLT 4.6.2019 £
IHT payable during lifetime				
Value of estate before gift			(80% shs)	
Value of estate after gift			(60% shs)	
Transfer of value	376,000	10,000	(100%)	100,000
Less: BPR				
Less: Marriage exemption		(5,000)		
Less: Annual exemption				
Current year	2012/13	2016/17	2016/17	2019/20
Previous year	2011/12 b/f	2015/16 b/f	2015/16b/f	2018/19 b/f
Chargeable amount	Net	0	0	Net
NRB at date of gift	£			£
– 2012/13	325,000			
– 2019/20				325,000
Less: GCTs < 7 years before gift				
(4.7.2005 – 4.7.2012)	(0)			
(4.6.2012 – 4.6.2019)				(381,250)
(ignore PETs)				
NRB available	(325,000)			(0)
Taxable amount	45,000	0		94,000
IHT payable	@ 25%	11,250	0	23,500
Paid by	Alwyn			Alwyn
Due date of payment	30.4.2013			30.4.2020
Gross chargeable amount c/f	(£370,000 net + £11,250 tax)	381,250	0	(£94,000 net + £23,500 tax)

Notes: CLT – 4.7.2012
CLT – 4.6.2019

No further IHT is due in respect of the first CLT as Alwyn has survived the gift by more than seven years.
Should Alwyn die before 4 June 2026, additional IHT at death rates of 40% may become payable on the last CLT.
Taper relief may be available and the lifetime tax paid is an allowable deduction

4 March 2017 – Gift to son – explanation

The wedding gift of £10,000 to Iwan, being made from one individual to another, will be a PET. There is no IHT payable during Alwyn's lifetime and providing Alwyn survives until 4 March 2024 no IHT will arise in relation to this gift.

However, if Alwyn dies before 4 March 2024, the PET will become chargeable.

As the gift was made in consideration of marriage, a marriage exemption of £5,000 will be available for gifts from a parent to their child. As there is another gift on the same day (see below) Alwyn's 2016/17 AE may need to be apportioned by reference to the value of the gifts made on the same day. The AE is, however, only used after other exemptions and reliefs.

The gift of shares in GG Ltd made on the same day to Elinor is likely to qualify for 100% BPR (see below). It is likely therefore that the entire AE for 2016/17 will be allocated against the wedding gift to the son.

The PET is therefore valued at £Nil. There will be no IHT payable, even if Alwyn does not survive seven years after making the gift.

4 March 2017 – Gift to daughter – explanation

The gift of shares to Elinor, being made from one individual to another, will also be a PET. As mentioned above, this gift would have been entitled to a share of the AE. It wasn't necessary to apportion the AE in this case due to the availability of BPR.

The shares will be valued applying the loss to the donor's estate principle. Before the gift Alwyn owned an 80% holding (see tutorial note) and after the gift Alwyn owned a 60% holding. The value of the transfer is therefore £150,000 (£600,000 – £450,000).

As the GG Ltd shares are unquoted trading company shares and Alwyn owned the shares for the minimum qualifying period of two years prior to the gift, BPR at the rate of 100% is likely to be available. Therefore, no IHT is payable on this PET at the time of the gift.

In addition, IHT is not payable on the death of Alwyn within seven years unless, upon Alwyn's death before 4 March 2024, Elinor has ceased to own the shares gifted to her or GG Ltd has ceased to be a qualifying company.

Note: The question says Alwyn currently (in 2023) owns a 60% holding. At the time of the gift in March 2017, he must therefore have had an 80% holding.



Mary

Answer 1 – Chapter 12

Mary's previous chargeable lifetime transfer for £335,000 will have fully utilised her nil rate band of £325,000.

(a) Holiday cottage

Where an individual makes a gift of property but reserves a benefit, the special gift with reservation (GWR) rules will apply.

Short holiday visits to the cottage would not be caught by the rules, however six months free use would make the gift a GWR.

The gift of the cottage will be a PET of £100,000, ignoring AEs per question but Mary will still be treated as beneficially entitled to the cottage.

It will therefore be included as part of her estate when she dies, and will be included at its value on the date of death.

This might give rise to a double charge to IHT, since the cottage is a PET and also part of Mary's estate.

Relief for the double charges will be given if this is the case, by only considering the treatment (PET or inclusion in death estate) that gives the higher IHT payable.

Mary could avoid the GWR rules by paying a commercial rent for the use of the cottage.

(b) Antique clock

The gift of the clock is in consideration of marriage by a grandparent to a grandchild. It will therefore qualify for a wedding gift exemption of £2,500.

The balance of the gift will be a PET of £7,500 (ignoring AEs per question).

(c) DEF Ltd shares

The gift of 20,000 shares in DEF Ltd out of an existing shareholding of 30,000 shares into a discretionary trust will be a CLT.

	£
Value of estate before the gift:	
30,000 shares valued at £16 each	480,000
Value of estate after the gift:	
10,000 shares valued at £10 each	(100,000)
	<hr/>
Transfer of value	380,000
	<hr/>

BPR is not available because Mary has owned the shares for less than two years. Therefore, the chargeable amount of the CLT is £380,000 (ignoring AEs per question).

As Mary is to pay the lifetime IHT liability and there is no nil rate band available, she will have to pay IHT of £95,000 ($£380,000 \times 25\%$).

The gross chargeable amount of the transfer is therefore £475,000 ($£380,000 + £95,000$).

(d) Agricultural land

The gift of agricultural land will be a PET with a transfer of value of £280,000.

The increase in the value of David's land is irrelevant.

If the PET becomes chargeable as a result of Mary dying within seven years, APR at the rate of 100% should be available as Mary has owned the land for seven years.

However, APR will only be available on the agricultural value of £160,000.

The relief will only be available if David still owns the land, and it is still agricultural property, at the date of Mary's death.



Thelma

Answer 2 – Chapter 12

(i) Thelma retains assets until death

IHT implications

Cash gift – September 2022

The cash gift made to Louise in September 2022 is a PET which will become chargeable if Thelma dies within seven years of making the gift. There are no other lifetime gifts.

If Thelma therefore dies within four years' time (i.e. on or before 30 June 2028) IHT will become payable on the PET as follows:

	£	£
Gross chargeable amount (after exemptions per question)		360,000
NRB at death	325,000	
GCTs in 7 yrs pre-gift (Sept 2015 – Sept 2022)	(0)	
	<u> </u>	(325,000)
Taxable amount		<u>35,000</u>
		£
IHT due on death (£35,000 × 40%)		14,000
Less: Taper relief (Sept 2022 to June 2028) (5 – 6 years) (60%)		<u>(8,400)</u>
Chargeable (40%)		5,600
Less: IHT paid in lifetime (PET)		<u>(0)</u>
IHT payable on death		<u>5,600</u>

Estate on death – 30 June 2028

	£	£
Residence		600,000
Blackbird plc shares		200,000
Robin plc loan stock – Thelma's share (£100,000 × 25%)		25,000
Cash deposits		160,000
Antique plates		10,000
Other chattels		20,000
		<u>1,015,000</u>
Less: Exempt estate (£600,000 + £20,000)		<u>(620,000)</u>
Gross chargeable estate		395,000
NRB at death	325,000	
GCTs in 7 yrs pre-death (30.6.2021 – 30.6.2028) (Include PET as chargeable on death)	(360,000)	
	<u> </u>	(0)
Taxable amount		<u>395,000</u>
IHT due on death (£395,000 × 40%)		<u>158,000</u>

CGT implications

Death is not a chargeable event for the purposes of CGT. Therefore, there is no CGT payable if Thelma retains the assets and gifts them in her will.

The recipients of the assets will receive them at their probate value which will form their base cost for future CGT purposes.

(ii) Thelma gifts selected assets to Louise now (6 July 2024)**IHT implications****Cash gift – September 2022**

The implications for the PET made in September 2022 are as above with £5,600 of IHT becoming payable as a result of Thelma's expected death in four years' time.

Gifts to Louise on 6 July 2024

The gifts of assets to Louise will be further PETs likely to become chargeable on Thelma's death, with further IHT arising as follows:

	Notes	£	£
Blackbird plc shares	(1)		146,200
Robin plc loan stock	(2)		25,750
Antique plates	(3)		6,333
Cash deposits			145,000
			<hr/>
			323,283
Less: AE – 2024/25			(3,000)
– 2023/24 b/f			(3,000)
Gross chargeable amount			317,283
NRB at death		325,000	
GCTs in 7 yrs pre-death (30.6.2021 – 30.6.2028)			
(Include PET as chargeable on death)		(360,000)	
		<hr/>	(0)
			<hr/>
Taxable amount			317,283
			<hr/>
IHT due on death (£317,283 × 40%)			126,913
Less: Taper relief (6.7.2024 to 30.6.2028) (3 – 4 years) (20%)			(25,383)
			<hr/>
Chargeable (80%)			101,530
Less: IHT paid in lifetime (PET)			(0)
			<hr/>
IHT payable on death			101,530
			<hr/>

Notes:

(1) Blackbird plc shares

Quarter up method = $(1,460p + (1,468p - 1,460p) \times 1/4) = £14.62$ per share

Value of 10,000 shares = $(10,000 \times £14.62) = £146,200$

There is no BPR available as the shares are quoted shares and Thelma does not have a controlling interest.

(2) Robin plc loan stock

Quarter up method = $(102p + (106p - 102p) \times 1/4) = 103p$ per share

Value of loan stock = $(£100,000 \times £1.03 \times 25\%) = £25,750$

(3) Value of the plates

Valued under related party valuation rules, taking account of the fact that Thelma and Gordon own five plates between them (the daughter Louise's plate does not count as related property).

Value of 3 plates/Value of 3 + 2 plates

= $[£3,800 / (£3,800 + £2,200)] \times £10,000 = £6,333$

Estate on death

When Thelma dies the transfers of the house and personal chattels to Gordon will be exempt under the inter-spouse provisions.

Therefore, there is no IHT payable on the estate at death.

CGT implications

Gift of cash and loan stock.

The gifts of cash deposits and loan stock (a qualifying corporate bond) are exempt from CGT.

Gift of plates

Whilst the plates form a set, because Thelma has never in the past owned the plates which are owned by her husband and daughter there is no need to treat the gift of her plates to Louise as a part disposal nor to amalgamate the gift with any previous gifts.

The value of the consideration for CGT purposes will simply be the market value of the three plates gifted by Thelma (i.e. £3,800). As their value is less than £6,000 and they cost less than £6,000, any gain arising will also be exempt under the CGT chattels rules.

Gift of Blackbird plc shares

The gift of these shares will, however, give rise to a chargeable gain. Assuming the gift is made on 6 July 2024, the CGT will be:

	£
Market value (connected persons) (Note)	146,400
Less: Cost (£25,000 + £50,000)	(75,000)
	<hr/>
Chargeable gain	71,400
	<hr/>

Business asset disposal relief is not available as Thelma owns 1% of the shareholding. Gift holdover relief is not available as the shares are quoted and Thelma has a < 5% interest in the company.

	£
Total chargeable gains	71,400
Less: AEA	(6,000)
	<hr/>
Taxable gains	65,400
	<hr/>
CGT (£65,400 × 20%)	13,080
	<hr/>

Conclusion

The tax payable under both options is as follows:

	IHT £	CGT £	Total £
Retention of assets (£5,600 + £158,000)	163,600	0	163,600
Gifting assets now (£5,600 + £101,530)	107,130	13,080	120,210

It would therefore appear that, providing the key assumptions hold (i.e. asset values in four years, Thelma survives four years), it is preferable to make the gifts to Louise now giving a tax saving of £43,390 (£163,600 – £120,210).

Note: The valuation for CGT is different from the IHT valuation used for the PET calculation above.

For CGT, quoted shares are valued at the average of the highest and lowest prices:

$$= (1,468p + 1,460p) \times 1/2 = 1,464p \text{ per share}$$

$$\text{Value of 10,000 shares} = (10,000 \times £14.64) = £146,400$$



The Wood Discretionary Trust

Answer 1 – Chapter 13

Notes for meeting with trustees

Income tax in relation to the Wood Discretionary Trust

(1) Basis of assessment

- All trusts are subject to income tax on trust income received on a tax year basis.
- Trustees of all trusts are subject to self-assessment under the same system applying to individuals.
- When income payments are made to a beneficiary, the trustees pay the income net of 45% tax credit.

(2) Payment of income made to a beneficiary

If a discretionary payment is made in the tax year:

- The beneficiary is taxed on the gross income actually received in the tax year.
- The income received is grossed up at 100/55, and included in the beneficiary's IT computation as non-savings income.
- A tax credit of 45% is deducted in the beneficiary's IT liability computation.
- A 'statement of trust income' form must be completed for HMRC to show the gross, tax and net amounts distributed to the beneficiary in that tax year.

CGT in relation to the Wood Discretionary Trust

(1) Occasions of charge

Trustees are chargeable persons for the purposes of CGT and therefore a liability to tax may arise where a trustee makes a chargeable disposal of a chargeable asset.

There are three main occasions of charge to CGT:

- When assets are put into trust (this is a charge on the individual settlor, not the trust itself)
- Disposals of trust assets by the trustees to persons other than the beneficiaries when they are managing the trust assets
- When capital assets are distributed to the beneficiaries.

(2) Assets put into trust on death

- Not a chargeable disposal as trust set up on death in a will
- No CGT payable
- Trustees acquire assets at probate value.

(3) Disposals of trust assets by trustees to persons other than the beneficiaries

- Chargeable disposals of chargeable assets give rise to chargeable gains
- CGT payable by the trustees on a tax year basis under self-assessment.

(4) Distribution of capital assets out of the trust to beneficiaries

- Chargeable disposal of asset at full market value
- Gift holdover relief available on any asset as there is an immediate charge to IHT
- Beneficiary acquires the assets at base cost = market value less gift holdover relief.

IHT in relation to The Wood Discretionary trust**(1) Basis of assessment**

- Taxed as a separate entity with its own nil rate band.

(2) Occasions of charge

There will be three key occasions of charge to IHT as follows:

- When assets are put into trust
- The principal charge every ten years following the creation of the trust
- When capital assets are distributed out of the trust to the beneficiaries.

(3) Assets put into trust on death

- Assets form part of the settlor's estate on death
- IHT payable on the estate

Note there is no difference in IHT payable on the estate if an individual puts their estate into a trust on death or leaves the estate directly to another individual

- Trust established after the estate IHT has been paid (i.e. out of assets after tax).

(4) The principal charge

- An anniversary charge every tenth anniversary of the creation of the trust is levied on the market value of all of the assets in the trust on the anniversary date
- The maximum rate of IHT is 6%.

(5) **Distribution of capital assets out of the trust to beneficiaries**

- Exit charge arises
- The maximum rate of IHT is 6%.



Danny

Answer 1 – Chapter 16

(a) **Income tax computation – 2023/24**

	£
Employment income (£28,505 + £2,100)	30,605
Building society interest	2,500
Property income (Note)	2,150
UK dividends received	1,300
	<hr/>
Total income	36,555
Less: Relief – Qualifying loan interest	(1,500)
	<hr/>
Net income	35,055
Less: PA	(12,570)
	<hr/>
Taxable income	22,485
	<hr/>

Analysis of income:

Dividends Savings Non-savings income

£1,300 £2,500 (£22,485 – £1,300 – £2,500) = £18,685

Income tax

	£		£
Non-savings – basic rate	18,685	× 20%	3,737
Savings income – SNRB	1,000	× 0%	0
Savings income – basic rate	1,500	× 20%	300
Dividend income – DNRB	1,000	× 0%	0
Dividend income – basic rate	300	× 8.75%	26
	<hr/>		<hr/>
	22,485		
	<hr/>		<hr/>

Income tax liability	4,063
Less: Tax credits – PAYE	(3,201)
	<hr/>
Income tax payable	862
	<hr/>

Note: The property income, being joint income received by civil partners, is divided between Danny and Ben on a 50:50 basis ($£4,300 \div 2 = £2,150$).

As Ben and Danny both use their PA and Ben is a HR taxpayer, it is not possible to claim the marriage allowance.

- (b) Currently, in the tax year 2023/24, Danny is a basic rate taxpayer. Accordingly, he is entitled to a £1,000 savings income nil rate band.

In the tax year 2024/25 and future years Danny's taxable income will exceed £37,700 and consequently his savings income nil rate band will be £500, the amount available to a higher rate taxpayer.

The remaining £2,000 of savings income will be taxed at 40%, resulting in £800 of income tax payable.

This is £500 higher ($£800 - £300$) than the tax currently payable by Danny on his savings income.



Blanca

Answer 2 – Chapter 16

(a) Income tax computation – 2023/24

	£	£
Employment income		14,500
Loan stock interest		
($£100,000 \times 10\% \times 1/2$) (Note)	5,000	
Interest on cash deposits	5,250	
	<hr/>	10,250
UK dividends ($10,000 \times 27.8p$)		2,780
		<hr/>
Total income		27,530
Less: PA		(12,570)
		<hr/>
Taxable income		14,960
		<hr/>

Analysis of income:

Dividends	Savings	Non-savings income
£2,780	£10,250	($£14,960 - £2,780 - £10,250$) = £1,930

Income tax

	£		£
Non-savings – basic rate	1,930	× 20%	386
Savings income – starting rate	3,070	× 0%	0
	<hr/>		
	5,000		
Savings income – SNRB	1,000	× 0%	0
Savings income – basic rate	6,180	× 20%	1,236
Dividend income – DNRB	1,000	× 0%	0
Dividend income – basic rate	1,780	× 8.75%	156
	<hr/>		
	14,960		
	<hr/>		
Income tax liability			<hr/> 1,778 <hr/>

Note: In the absence of a declaration of beneficial entitlement, the interest income on the Chaffinch plc loan stock will be shared equally between Blanca and Jorge.

(b) **Declaration of beneficial interest**

The effect of making a declaration of beneficial interest in respect of the loan stock in Chaffinch plc would be that Blanca would only be taxed upon her 25% beneficial entitlement with her husband Jorge being taxed on the remaining 75%.

This would reduce Blanca's taxable income from this source to £2,500 and hence her total income for the tax year 2023/24 would reduce to £25,030 (£27,530 – £2,500). This would save tax at 20% on £2,500.

However, the effect for Jorge would also need to be considered. If he is a higher rate or additional rate taxpayer the effect of the declaration would increase his income tax payable by 40% or 45% of the income transferred, which would negate the benefit of lower tax payable by Blanca.

**Leonor****Answer 1 – Chapter 17****(a) Employment income – 2023/24**

	£
Salary ($\text{£}32,000 \times 11/12$)	29,333
Payment in lieu of notice (Note)	8,000
Payment for agreeing not to work for competitors	17,500
Car benefit (W1)	3,428
	<hr/>
Employment income	58,261
	<hr/>

As the payment of £8,000 is in lieu of notice, it will be treated as a payment in respect of services provided and will be taxable in the tax year 2023/24, the year in which it is received.

The payment for agreeing not to work for competitors is a restrictive covenant payment and is specifically taxable as earnings in the year received.

Working: Car benefit

CO₂ emissions 102g/km, available for 11 months in the tax year 2023/24

	%
Petrol	16
Plus: $(100 - 55) \times 1/5$	9
	<hr/>
Appropriate percentage	25
	<hr/>
	£
List price ($\text{£}22,360 - \text{£}5,000$)	17,360
	<hr/>
Car benefit ($\text{£}17,360 \times 25\% \times 11/12$)	3,978
Less: Contributions for private use ($\text{£}50 \times 11$)	(550)
	<hr/>
Taxable benefits	3,428
	<hr/>

(b) (i) The share options

There are no income tax implications on the grant of the share options.

In the tax year in which Leonor exercises the options and acquires the shares, the excess of the market value of the shares over the price paid, i.e. £11,500 ($(\text{£}3.35 - \text{£}2.20) \times 10,000$) will be subject to income tax

Leonor's financial exposure is caused by the rule within the share option scheme obliging her to hold the shares for a year before she can sell them.

If the company's expansion into Eastern Europe fails, such that its share price subsequently falls to less than £2.20 before Leonor has the chance to sell the shares, Leonor's financial position may be summarised as follows:

- Leonor will have paid £22,000 ($£2.20 \times 10,000$) for shares which are now worth less than that.
- She will also have paid income tax of £4,600 ($£11,500 \times 40\%$).

(ii) **The flat**

The following additional information is required in order to calculate the employment income benefit in respect of the flat.

- The flat's annual value.
- The cost of any improvements made to the flat prior to 6 April 2024.
- The cost of power, water, repairs and maintenance, etc. borne by Summer Glow plc.
- The cost of the furniture provided by Summer Glow plc.
- Any use of the flat by Leonor wholly, exclusively and necessarily for the purposes of her employment.

The market value of the flat is not required as Summer Glow plc has owned it for less than six years.

Income tax consequences of requesting a more centrally located flat

One element of the employment income benefit in respect of the flat is calculated by reference to its original cost plus the cost of any capital improvements prior to 6 April 2024.

If Leonor requests a flat in a different location, this element of the benefit will be computed instead by reference to the cost of the new flat, which in turn equals the proceeds of sale of the old flat.

Accordingly, if, as is likely, the value of the flat has increased since it was purchased, Leonor's employment income benefit will also increase. The increase in the employment income benefit will be the flat's sales proceeds less its original cost less the cost of any capital improvements prior to 6 April 2024 multiplied by 2.25%.



Polina

Answer 1 – Chapter 18

Tax implications of letting property

In either case, Maksim will be taxed on the profits of a business of letting property. The assessment will be on an actual basis from 6 April to 5 April, and will be calculated on the cash basis (i.e. rent received less expenses paid) unless Maksim elects to use the accruals basis. Under the cash basis expenses will be deducted when paid. Allowable expenses are generally those incurred for the purposes of letting or trying to let the property.

Repairs to roof

The roof was damaged before Polina transferred the house to Maksim. Since the roof must be repaired before the house can be let, the house would not appear to be usable at the time of the transfer. The cost of repair of £24,000 is therefore likely to be classed as capital expenditure as it is pre-acquisition expenditure. This will increase Maksim's base cost for capital gains tax (CGT) purposes.

Let as unfurnished accommodation

The cost of decoration would normally be a revenue expense. However, some of the expenditure may be classed as capital if the house was in a bad state of repair on 31 December 2023. The decoration will presumably be carried out before letting commences, and so will be pre-trading expenditure. This will be allowed as an expense on the first day of business.

Any capital gain arising on the disposal of the house when Maksim retires at 60, will be fully chargeable.

Let as furnished holiday accommodation

The cost of converting the house into two separate units will be mainly capital expenditure, and this will increase Maksim's base cost for CGT purposes. The figure of £41,000 may include some revenue expenditure, such as decorating costs, and this will be treated as above. The £9,000 cost of furnishing the two units will be capital expenditure.

There are special rules assuming the letting qualifies as furnished holiday accommodation.

Maksim will be able to claim the following deductions from his annual gross rents of £45,000:

- (1) the loan interest of £4,000 (£50,000 at 8%). There is no restriction for finance costs when property is let as furnished holiday accommodation.
- (2) £9,000 deduction for the furniture. If the cash basis is used, then this is deductible when paid for. If the accruals basis is elected for then capital allowances in the form of an annual investment allowance of £9,000 will be available. If the property is not furnished holiday accommodation, only the cost of any replacement furniture will be deductible, not the initial cost.
- (3) the letting agency fees of £10,125 (£45,000 at 22.5%)
- (4) the other running costs of £3,500.

Note that expenses will be restricted if Maksim occupies the house for his own use.

The following advantages will also be obtained:

- the property income will qualify as relevant earnings for personal pension purposes
- business asset disposal relief will be available provided that all qualifying conditions are met
- rollover relief will be available on disposal
- gift holdover relief will be available if the property is gifted or sold at undervalue.

The letting of holiday accommodation is standard-rated for VAT purposes. The forecast rental income of £45,000 is below the VAT registration limit of £85,000, but the impact of VAT will have to be considered if Maksim is already registered for VAT, or if there is an increase in rental income.

Conclusion

Letting the house as furnished holiday accommodation will produce annual income before tax of approximately £27,375 (£45,000 – £4,000 – £10,125 – £3,500), compared to £28,000 (given in the question) if the house is let unfurnished.

It will also be necessary to incur additional expenditure initially of £46,400 (£41,000 + £9,000 – £3,600).

This must be compared against the potential CGT saving upon the disposal of the house arising from business asset disposal relief available for furnished holiday letting which is not available for unfurnished property.



Luciana

Answer 1 – Chapter 19

(a) (i) **Maximum pension contributions – 2023/24**

If Luciana sets up a personal pension scheme in the tax year 2023/24 the maximum gross pension contributions that Luciana can make into the scheme are restricted to the higher of:

- £3,600, or
- 100% of her earned income = £15,000.

Note that the dividend income does not count as earnings and is not relevant in determining the level of pension contribution.

To obtain relief in the current 2023/24 tax year the contributions need to be paid by 5 April 2024.

This will mean that Luciana can make a maximum gross contribution of £15,000 by 5 April 2024.

(ii) **Method of obtaining tax relief**

Tax relief for contributions into pension schemes is given as follows.

- Basic rate tax relief is given at source. Assuming the maximum contribution possible is paid, Luciana will actually pay £12,000 ($£15,000 \times 80\%$) to the pension provider.
- Higher rate tax relief is given by extending her basic rate band and higher rate tax limit by £15,000 (i.e. the gross amount of the pension contribution paid).

The effect of making such contributions on her 2023/24 income tax liability will be a £15,000 reduction in her dividend income liable to the higher 33.75% tax rate applicable to dividend income. As a result, her income tax liability will be reduced by £3,750 (W).

(iii) **Tax implications of the company pension contributions**

It is possible to set up the scheme such that Scott Engineering Ltd pays all or some of the pension contributions. If this is the case the total combined contributions that may be paid by the employee and her employer on which tax relief can be obtained is restricted to the annual allowance of £40,000 for the tax year 2023/24. The annual allowance may not be brought forward from the previous three tax years, 2020/21 to 2022/23, as Luciana was not a member of a pension scheme.

If Scott Engineering Ltd pays any contributions, these will be paid gross and the company will obtain corporation tax relief on the contributions at 25%.

These contributions will not be treated as employee benefits or be liable to class 1 NICs

If total contributions in excess of the annual allowance are made, Luciana will be liable to income tax at her marginal rate on the excess.

Whether direct contributions by Scott Engineering Ltd are more beneficial than personal contributions by Luciana will depend upon several factors, such as:

- (1) whether Luciana's income is reduced to reflect the contributions paid by the company
- (2) if income is so reduced whether this is the dividend income (for which no corporation tax deduction is available) or her salary (which already obtains corporation tax relief and is liable to employer's class 1 NICs), and
- (3) the marginal tax rates of Luciana and the company.

(b) Alternative pension arrangements

As Luciana is an employee of Scott Engineering Ltd the principal alternative pension arrangement that could be made would be for the company to set up an occupational pension scheme.

This is usually set up in the form of an irrevocable trust to ensure that the scheme assets are held independently of the employer.

The amount of tax relief that can be obtained is the same under either a personal pension scheme or an occupational scheme. However, the method of obtaining the tax relief is different.

The method of relief for such schemes is as follows:

- employee contributions are deducted from employment income and tax relief is given at both the basic and higher rates via the PAYE system.
- employer contributions are tax deductible when paid for corporation tax purposes and are not regarded as employee benefits nor are they liable to class 1 NICs.

Working: Income tax relief via the income tax computation

	£
Employment income	15,000
UK dividends	51,500
	<hr/>
Total income	66,500
Less: PA	(12,570)
	<hr/>
Taxable income	53,930
	<hr/>

Analysis of income:

Dividends	Savings	Non-savings income
£51,500	£0	(£53,930 – £51,500) = £2,430

Income tax before pension contribution

	£		£
Non-savings income	2,430	× 20%	486
Dividend NRB	1,000	× 0%	0
Dividend income	34,270	× 8.75%	2,999
	<hr/>		
	37,700		
Dividend income	16,230	× 33.75%	5,478
	<hr/>		
	53,930		
	<hr/>		<hr/>
Income tax liability			8,963

Income tax after pension contribution

	£		£
Non-savings income	2,430	× 20%	486
Dividend NRB	1,000	× 0%	0
Dividend income	49,270	× 8.75%	4,311
	<hr/>		
Extended basic rate band (W)	52,700		
Dividend income	1,230	× 33.75%	415
	<hr/>		
	53,930		
	<hr/>		<hr/>
Income tax liability			5,212
			<hr/>
Income tax reduction = (£8,963 – £5,212) (rounded)			3,750
			<hr/>

Alternative calculation: £15,000 × (33.75% – 8.75%) = £3,750

Working: Extended basic rate band

	£
Basic rate band	37,700
Plus: Gross PPCs	15,000
	<hr/>
	52,700
	<hr/>



Miguel

Answer 1 – Chapter 20

(a) Tax status of Miguel

Residence (R)

In the tax year 2023/24 Miguel is automatically UK resident as he will be working in the UK for at least 365 days continuously, some of which falls into this tax year.

He will also be:

- UK resident in the following year (see below),
- but has not been UK resident prior to arriving in the UK, and
- arrives in the UK part way through the current tax year to take up full time work in the UK.

Accordingly, the split year basis applies in the tax year 2023/24, and the UK part starts the day he starts work in the UK (13 January 2024).

In the tax year 2024/25 Miguel will be automatically UK resident as he will be in the UK for at least 183 days in the tax year.

Domicile

Domicile is the place a person regards as his, her or their permanent home. As Miguel was born and lived in Portugal until his move to England this will be his domicile of origin.

It appears that Miguel intends to return there, and so will retain his Portuguese domicile for UK tax purposes.

Miguel would be deemed to be UK domiciled if he remained UK resident for at least 15 years, but not if he returns to Portugal after three years.

Effect on tax computation

All Miguel's UK income will be taxable. With regard to his overseas income the amount taxable in the UK will depend on his tax status.

His investment income and overseas rent will be taxable on an arising basis if he acquired UK domicile as well.

However, if, as appears likely here, he remains non-UK domiciled, he can elect to be taxed on the remittance basis for his overseas income as his unremitted income is in excess of £2,000 (unremitted dividends of £650, bank interest of £1,600 and rental income of £28,000 paid into his Portuguese bank account).

The election will result in Miguel only being taxed on overseas investment income remitted to the UK, but with the loss of his personal allowance.

Note that he will not be subject to the £30,000 remittance basis charge as he has not been resident in the UK for more than seven years.

Basis of taxation

Where overseas income is taxed on a remittance basis, regardless of the source of income, it is treated as 'non-savings income' for the purposes of identifying how much UK tax is payable and for calculating the DTR available.

(b) Income tax computation – 2024/25

Miguel will elect to be taxed on the remittance basis as the saving from omitting the unremitted foreign income (£30,250) outweighs the loss of the personal allowance (£12,570).

	£
Salary – UK	44,000
Benefits (W1)	37,673
	<hr/>
Employment income	81,673
Rental income – overseas (none remitted)	0
UK dividends	4,000
UK bank interest	1,100
Overseas dividends (amount remitted)	2,500
Overseas bank interest (amount remitted)	1,300
	<hr/>
Total income	90,573
Less: PA (none as remittance basis claimed)	(0)
	<hr/>
Taxable income	90,573
	<hr/>

Analysis of income:			£
Savings income (UK)			1,100
Savings income (overseas)			1,300
Dividends (UK)			4,000
Dividends (overseas)			2,500
Non-savings income			81,673
Income tax			
	£		£
Non-savings income	37,700	× 20%	7,540
Non-savings income	43,973	× 40%	17,589
	<hr/>		
	81,673		
UK savings – NRB	500	× 0%	0
UK savings	600	× 40%	240
Overseas savings	1,300	× 40%	520
UK dividends – NRB	1,000	× 0%	0
UK dividends	3,000	× 33.75%	1,013
Overseas dividends remitted	2,500	× 40%	1,000
	<hr/>		<hr/>
	90,573		27,902
	<hr/>		
Plus: Remittance basis charge (not applicable)			0
			<hr/>
			27,902
Less: DTR (£2,500 + £1,300) × 10% (W2)			(380)
			<hr/>
Income tax liability			27,522
			<hr/>

Workings**(W1) Benefits**

Company car		£
Appropriate percentage		
$= (120 - 55) \div 5 + 16\% = 29\%$		
Car benefit (£28,000 × 29%)		8,120
Fuel benefit (£27,800 × 29%)		8,062
Medical insurance		1,431
Living accommodation		
Annual value	4,500	
Expensive accommodation charge		
$(£187,000 - £75,000) \times 2.25\%$	2,520	
Running costs	5,700	
Use of furniture (£49,000 × 20%)	9,800	
	<hr/>	
	22,520	
Less: Rent paid (£1,300 × 12)	(15,600)	
	<hr/>	6,920
School costs (£1,500 × 7)		10,500
Mobile phone – exempt		0
Health club (£220 × 12)		2,640
		<hr/>
Total benefits		37,673
		<hr/>

(W2) DTR

For the purposes of DTR each source of overseas income must be dealt with separately.

The tax on the overseas income is then compared with the UK tax on that source, and relief given for the lower of the two.

In this example both sources of income had 10% overseas tax deducted at source, and the UK rate is clearly higher, therefore the computation has taken the shortcut of just deducting DTR as the 10% overseas tax suffered.

Where the UK tax rate is clearly in excess of the overseas tax rate, an approach like this would be acceptable in the exam providing the answer is suitably annotated to explain the approach.



Roberta

Answer 2 – Chapter 20

(a) Roberta's tax status

2023/24

In the tax year 2023/24, Roberta is automatically UK resident as she is in the UK for at least 183 days in the tax year.

She was also:

- UK resident in the previous tax year 2022/23
- is not UK resident in the tax year 2024/25 (see below)
- leaves part way through the tax year because she begins working abroad on a full-time contract, and
- does not return to the UK for more than the permitted number of days in the UK after departure.

Accordingly, the split year basis will apply and the overseas part starts the date she starts her overseas work (2 January 2024).

2024/25 to 2026/27 inclusive

Roberta will be automatically non-UK resident as she does not intend to visit the UK at all in the tax year.

2027/28

In the tax year 2027/28, Roberta is automatically UK resident as she is in the UK for at least 183 days in the tax year.

She was also:

- not UK resident in the previous tax year 2026/27
- arrives in the UK part way through the tax year because she ceases to work abroad on a full-time contract
- returns to the UK, and
- is resident in the following tax year.

Accordingly, the split year basis will apply and the UK part starts the date she ceases to work overseas (31 May 2027).

(b) Roberta's assessment to chargeable gains

As Roberta has been UK resident for at least four of the seven tax years prior to her departing the UK, it is necessary to consider if she will be considered a temporary non-resident for the purposes of capital gains tax. This will be the case if she is non-UK resident for no more than five years.

Temporary non-UK residence starts from the start of the overseas part in the split year of departure = 2 January 2024

Temporary non-UK residence ends from the start of the UK part in the split year of return = 31 May 2027

Roberta's period of temporary non-UK residence is therefore less than five years and so the temporary non-residence rules apply.

Therefore, the gains are taxed as follows:

2023/24 = Split year

- taxable on worldwide gains
- on disposals before the date of departure

2024/25 to 2026/27 inclusive = abroad

- not taxable on any gains at the time (except on UK property)

2027/28 = Year of return = split year

- on re-entry into the UK within five years = taxable on any gains arising whilst abroad relating to assets owned before departure from the UK, and
- gains in that year arising after the return to the UK.

Therefore, the gains/losses on the disposals in both May 2024 and July 2024 will become chargeable in the tax year 2027/28 when Roberta returns to the UK.

Disposals:	May 2024 £	July 2024 £
Sale proceeds	195,000	26,500
Less: Cost	(76,000)	(54,000)
Chargeable gain/(Allowable loss)	119,000	(27,500)
Net chargeable gains – taxed in 2027/28	£91,500	



Ali

Answer 1 – Chapter 21

Loss relief options available:

- **Relief against total income**

This relief allows trading losses to be set against the total income of the current and /or the previous tax year.

- **Relief against gains**

This relief is allowed after a claim against total income has been made. It allows relief to be claimed against chargeable gains. The trading loss is 'converted' into a current year capital loss.

- **Carry forward relief**

This relief is automatic if no other claim is made. It allows trading losses to be carried forward and set against the first available trading profits of the same trade.

Optimum use of losses:

- **If relief against total income and gains is claimed:**

If relief is claimed against total income and gains, the trading loss of £18,000 incurred in the tax year 2023/24 can be set against total income and gains in the tax year 2023/24 and/or 2022/23.

Allocated against the current year – 2023/24

If the trading loss of £18,000 is set against the interest and property income of the tax year 2023/24 (£13,220 see below), this would utilise most of the loss but the PA and savings income nil rate band would be wasted. There would be no tax saved, as without the loss the PA would be set against the non-savings income in preference to the savings income, and the remaining savings income would be taxed at 0% as it would fall within the first £5,000 of taxable income.

There would be £4,780 of loss left (£18,000 – £13,220) to allocate against the chargeable gain. However, when considering whether to allocate a loss against the chargeable gain, consideration should be given to the other reliefs that may be wasted such as the AEA of £6,000 and the rate of CGT applicable.

Before considering relief against gains, it should be noted that the chargeable gain is almost covered by the capital losses brought forward and the AEA (£20,600 – £14,450 = £6,150).

A claim against gains is an 'all or nothing' relief. This means that you cannot choose how much of the loss can be utilised. If a claim is made, the maximum amount possible must be used, therefore all £4,780 of the loss would be utilised.

As a result, a small amount of tax is saved £27 (£150 see below × 18%). Note that the tax saving is at 18% as Ali is a basic rate taxpayer and the gain is in respect of a residential property.

Accordingly claims against total income and gains in the tax year 2023/24 are not an attractive option.

Allocated against the previous year – 2022/23

If the loss was to be set against the total income of the previous year (£72,890 see below) the loss and PA would be set against the non-savings income in preference to the saving income to preserve the savings income nil rate band. The loss would therefore give income tax relief at 40% and would not waste the PA nor the savings income nil rate band.

The tax saving is £7,200 ($£18,000 \times 40\%$).

This method utilises the loss as quickly as possible and will help Ali's cash flow position.

- **If losses are carried forward:**

If the loss is carried forward, the loss of £18,000 would be set against the next available profits from the same trade of £26,000 in the tax year 2024/25.

The total income for the year would be £14,840 ($£26,000 - £18,000 + £6,840$). The PA would not be wasted; however, the tax relief would only be £3,600 ($£18,000 \times 20\%$).

- **Conclusion:**

Ali should claim relief against his total income of 2022/23 and an income tax saving of £7,200 will be achieved.

Taxable income computations

	2022/23	2023/24	2024/25
	£	£	£
Trading income	55,000	0	26,000
Less: Loss relief b/f	(0)	(0)	(0)
	<hr/>	<hr/>	<hr/>
	55,000	0	26,000
Bank interest	8,690	5,400	0
Property income	9,200	7,820	6,840
	<hr/>	<hr/>	<hr/>
Total income before reliefs	72,890	13,220	32,840
Less: Loss relief	(18,000)	(0)	
	<hr/>	<hr/>	<hr/>
Net income after reliefs	54,890	13,220	32,840
Less: PA	(12,570)	(12,570)	(12,570)
	<hr/>	<hr/>	<hr/>
Taxable income	42,320	650	20,270
	<hr/>	<hr/>	<hr/>

Taxable gain computation – 2023/24

	£
Gain in the year	20,600
Less: Trading loss relief	(0)
	<hr/>
	20,600
Less: AEA	(6,000)
	<hr/>
Net chargeable gain	14,600
Less: Capital loss b/f	(14,450)
	<hr/>
Taxable gain	150
	<hr/>



Lotte and Fien

Answer 2 – Chapter 21

(a) (i) **Taxation implications for Lotte of involving her wife in the business**

Employing Fien

If Lotte employs her wife, she is only able to claim a tax deduction for the salary paid if she pays her the market rate. As she was earning £13,200 (£1,100 × 12) as a bookkeeper previously, this would appear to be the market rate.

The business must pay employers' NICs at 13.8% on her gross salary in excess of £9,100 p.a. However, there is an allowance of £5,000 available for employers to set against the liability.

The salary and NICs will both be tax deductible expenses for the business.

Fien will have to pay NICs at 12% as an employee on her salary in excess of £12,570 and will be taxed on her salary under PAYE.

Note: The employment allowance is available even though Fien is the only employee. The allowance is only not available if it is a company and a director is the sole employee earning more than £9,100.

Setting up a partnership

If Lotte and Fien are in equal partnership, they will each be assessed to income tax on half of the partnership profits.

In addition, Fien will pay class 4 NICs at a maximum rate of 9% and class 2 at a fixed rate of £179 for the year. This is compared to employee class 1 NICs of 12% for Fien and employer's class 1 NICs of 13.8% for the business, as an employee.

No tax deductions will be made for any payments to Fien.

Calculation of income tax and NICs under each option assuming a full year of operation

(1) Fien as an employee

Employment costs relating to Fien

	£	£
Salary		13,200
Employers' NICs (£13,200 – £9,100) × 13.8%	566	
Less: Employment allowance (max £5,000)	(566)	
	<hr/>	0
Employment costs		<hr/> 13,200

This amount is tax deductible for the business.

Income tax and NICs payable by Lotte

	£
Trading income (£40,000 – £13,200)	26,800
	<hr/>
Income tax (£26,800 × 40%)	10,720
Class 2 NIC (52 × £3.45)	179
Class 4 NIC (£26,800 – £12,570) × 9%	1,281
	<hr/>
Total income tax and NIC	<hr/> 12,180

Note: In addition, Lotte will have property income which will utilise her PA and basic rate band. The above calculation is just isolating the impact of her trading profits on her IT and NIC position.

Income tax and NIC payable by Fien

	£
Salary	13,200
Less: Personal allowance	(12,570)
	<hr/>
Taxable income	630
Income tax (£630 × 20%)	126
Class 1 NICs (£13,200 – £12,570) × 12%	76
	<hr/>
Total income tax and NIC	202
Total tax payable by the couple (£12,180 + £202)	12,382
	<hr/>

(2) Fien as a partner, sharing profits 50:50 (Lotte: Fien)

The profits for a full year will be allocated £20,000 (£40,000 × 50%) each to Lotte and Fien.

Income tax and NIC payable by Lotte

	£
Income tax (£20,000 × 40%)	8,000
Class 2 NIC (52 × £3.45)	179
Class 4 NIC (£20,000 – £12,570) × 9%	669
	<hr/>
Total income tax and NIC	8,848
	<hr/>

Note: In addition, Lotte will have property income which will utilise her PA and basic rate band.
The above calculation is just isolating the impact of his trading profits on his IT and NIC position.

Income tax and NIC payable by Fien

	£
Trading income	20,000
Less: Personal allowance	(12,570)
	<hr/>
Taxable income	7,430
	<hr/>

	£
Income tax ($£7,430 \times 20\%$)	1,486
Class 2 NIC ($52 \times £3.45$)	179
Class 4 NIC ($£20,000 - £12,570 \times 9\%$)	669
	<hr/>
Total income tax and NIC	2,334
	<hr/>
Total tax payable by the couple ($£8,848 + £2,334$)	11,182
	<hr/>

Conclusion

By operating as an equal partnership, the couple can achieve a tax saving of £1,200 ($£12,382 - £11,182$).

If Lotte and Fien are in partnership, then the profit-sharing ratios can be in any proportion they decide. The ratio does not have to reflect their respective input to the business provided there is a proper partnership agreement and Fien takes an active part in the business.

The ratio can therefore be chosen so as to reduce their overall tax liability, and may even be changed at a later date if their circumstances change.

Lotte has property income of £55,000 from the tax year 2024/25 onwards and so she will be a higher rate taxpayer. Fien has no other income, and could receive up to £50,270 (i.e. the PA of £12,570 plus the basic rate band of £37,700) before paying tax at higher rates.

A bigger saving could, therefore, be achieved by Fien having a higher proportion of the profits.

However, the question told you that Lotte would take Fien on as an equal partner.

(ii) Tax administration

Notification of new source of income in the tax year 2023/24

For income tax purposes HMRC should be notified by 5 October 2024 (i.e. within six months from the end of the tax year in which the liability on the new source of income arises).

Submission of tax return

Lotte's self-assessment return due filing date for the tax year 2023/24 depends upon whether she intends to file electronically or in paper format.

If she decides to file in paper format it is due on the later of:

- (1) 31 October 2024
- (2) Three months after the notice to file the return is issued.

If she files electronically it is due on the later of:

- (1) 31 January 2025
- (2) Three months after the notice to file the return is issued

Payment dates

Income tax is normally payable as follows:

31 January in the tax year	Payment on account
31 July following the tax year	Payment on account
31 January following the tax year	Balancing payment

However, as the payments on account are each based on 50% of the previous year's income tax and NIC liability, this is not possible in the first tax year.

Thus, if the business starts to trade on 1 January 2024, the first payment on account is due on 31 January 2024, but no payment will be made, as trade has just started. The second payment on account is due on 31 July 2024, but again, it is unlikely that any payments will be made as there was no liability in the prior year. The balancing payment is due on 31 January 2025, and the total liability will be paid on that date.

(b) Loss reliefs available to Lotte

The loss relief options available to Lotte are as follows:

- (1) Relief against total income of the previous three tax years on a first in first out (FIFO) basis.
- (2) Relief against total income (and gains, if required) of the current tax year and/or the previous tax year.
- (3) Relief by carrying forward against future trading profits of the same trade.

When deciding which loss relief to take, consideration should be given to the rate of tax saved, to the timing of any relief/repayment and to avoiding the loss of personal allowances.

Note: In this question there is no savings income or dividends, therefore the preservation of the nil rate bands is not a consideration.

The profit-sharing ratio is 50:50, so the loss arising to Lotte (and Fien) in the tax year 2023/24 is £20,000 each.

Lotte – the most beneficial claim

Lotte has had employment income of £55,000 p.a. since 2009, with £41,250 ($£55,000 \times 9/12$) in the tax year 2023/24. Lotte will also have total income of £75,000 (£55,000 property income + £20,000 equal share of trading profits) from the tax year 2024/25 onwards.

The tax saving achieved under each option is as follows:

- (1) Carry the loss back three years to the tax year 2020/21 and receive a repayment of income tax of £4,946 (W1)
- (2) Use the loss against total income in the tax year 2023/24 resulting in a tax saving of £4,000 (W2) or against total income in the tax year 2022/23 resulting in a tax saving of £4,946 (W1); or
- (3) Carry forward the loss against trading profits in the tax year 2024/25 saving tax of £8,000 (W3).

Ignoring the timing of tax saving, the greatest tax is saved if the loss is carried forward to the tax year 2024/25.

Workings**(W1) Using the loss in the tax year 2020/21 or 2022/23**

	Before loss relief £	After loss relief £
Employment income	55,000	55,000
Less: Loss relief	0	(20,000)
	<hr/>	<hr/>
Net income	55,000	35,000
Less: Personal allowance	(12,570)	(12,570)
	<hr/>	<hr/>
Taxable income	42,430	22,430
	<hr/>	<hr/>
Tax saving: loss of £20,000		
Relief at higher rate (£42,430 – £37,700)	4,730 × 40%	1,892
Remainder at basic rate (£20,000 – £4,730)	15,270 × 20%	3,054
	<hr/>	<hr/>
Total loss	20,000	
	<hr/>	<hr/>
Tax saved		4,946
		<hr/>

(W2) Using the loss in 2023/24

	Before loss relief	After loss relief
	£	£
Employment income (£55,000 × 9/12)	41,250	41,250
Trading profit	0	0
	<hr/>	<hr/>
	41,250	41,250
Less: Loss relief	0	(20,000)
	<hr/>	<hr/>
Net income	41,250	21,250
Less: Personal allowance	(12,570)	(12,570)
	<hr/>	<hr/>
Taxable income	28,680	8,680
	<hr/>	<hr/>
Tax saved: (£20,000 × 20%)		4,000
		<hr/>

(W3) Using the loss in 2024/25

	Before loss relief	After loss relief
	£	£
Trading profit (£40,000 × 50%)	20,000	20,000
Less: Loss relief	0	(20,000)
	<hr/>	<hr/>
	20,000	0
Property income	55,000	55,000
	<hr/>	<hr/>
Net income	75,000	55,000
Less: Personal allowance	(12,570)	(12,570)
	<hr/>	<hr/>
Taxable income	62,430	42,430
		<hr/>
Tax saved: (£20,000 × 40%)		8,000
		<hr/>

**Jane****Answer 1 – Chapter 22****(a) Options available for relief of loss**

Jane has made a trading loss in the tax year 2023/24 which is at the end of her trading cycle. The following represent the possible ways she can relieve this loss.

Relief against total income

The trading loss can be used in the tax year 2023/24 and/or 2022/23 against Jane's total income.

	2022/23	2023/24
Total income	£15,000	£Nil

By using the loss in the tax year 2022/23, Jane will waste her personal allowance. The rest of the loss will save tax at 20%, although part of the loss will remain unrelieved.

Relief against chargeable gains

After making a claim against total income in a particular tax year, it is also possible to make a further claim in the same year to reduce capital gains tax.

Depending on the consideration received, Jane may have a chargeable gain in 2023/24 realised on the disposal of the business and can use the loss to reduce this gain.

However, this will only save capital gains tax at 10%, as the disposal of the business qualifies for business asset disposal relief.

Terminal loss relief

As the loss arises in the last 12 months of trading, it can be carried back for three years on a LIFO basis and reduce trading profits of the previous three tax years.

	2020/21	2021/22	2022/23
Trading profits	£15,000	£6,000	£15,000

The loss would be used in the tax year 2022/23, then 2021/22, wasting two PAs and saving tax on the balance of the loss at 20%.

Incorporation relief

Special incorporation loss relief will be available if the consideration for the business is at least 80% in the form of shares.

The trading loss can be carried forward to the tax year 2024/25 and offset against the first available future income that Jane receives from the company.

	£
Employment income	60,000
Savings and dividend income	20,000
	<hr/>
Total income in 2024/25	80,000
	<hr/>

In Jane's case, the loss will be offset against her employment income of £60,000 from the company, Hollywood Ltd, saving tax mainly at 40% with no wasted PA and no wastage of the savings and dividend nil rate bands.

Conclusion

The most tax efficient use of the loss would be to carry it forward against Jane's employment income to save tax mainly at 40%, although there would be a slight cash flow disadvantage as relief would not be obtained until the tax year 2024/25.

(b) Capital gains implications of incorporation

Where all of the assets of Jane's business are transferred to Hollywood Ltd as a going concern wholly in exchange for shares, any capital gains arising are relieved via incorporation relief such that no capital gains tax liability arises.

However, where part of the payment received from the company is in the form of cash, Jane will have chargeable gains arising.

For Jane to have no liability to capital gains tax in the tax year 2024/25, assuming she has no other capital gains in the year, her chargeable gains must be covered by her AEA of £6,000.

	£
Gain on premises (£365,000 – £335,000)	30,000
Gain on goodwill	50,000
	<hr/>
Total capital gains before reliefs	80,000
	<hr/>
Chargeable gains required:	6,000
Incorporation relief should therefore be:	<hr/>
(£80,000 – £6,000)	74,000
	<hr/>

Therefore, the MV of the shares to be accepted should be:

$$£74,000 = £80,000 \times (\text{MV of shares}/£438,000)$$

$$\text{MV of shares} = £405,150$$

Therefore, the cash to accept as part of the consideration can be up to the value of £32,850 (£438,000 – £405,150) and there will be no capital gains tax arising on the transfer.

Alternative calculation:

$$(\text{Cash}/£438,000) \times £80,000 = £6,000$$

$$\text{Cash} = £32,850$$

The shares will have a capital gains tax base cost of:

	£
MV of shares (see above)	405,150
Less: Incorporation relief	(74,000)
	<hr/>
Base cost of shares	331,150
	<hr/>

If Jane wants to carry forward her losses, as explained above, then she must take at least 80% of the value as shares.

She should therefore take cash of no more than £87,600 (20% × £438,000) if she wants to be able to carry her losses forward to obtain maximum relief.

Cash of £32,850 would be well within this limit, therefore both CGT incorporation relief and incorporation loss relief would be available.



Barbara

Answer 2 – Chapter 22

(a) (i) Chargeable gain on the disposal of the business

		Gains/(losses)
Freehold premises:	£	£
Deemed proceeds (MV)	165,000	
Less: Cost	(65,000)	
Chargeable gain		100,000
Shop fittings – exempt		0
Shop front and canopy:		
Deemed proceeds (MV)	8,000	
Less: Cost	(13,165)	
Allowable loss		(5,165)
Net chargeable gains before reliefs		94,835
Less: Incorporation relief		(94,835)
Chargeable gain – 2023/24		0

Note 1: As all of the consideration is received in the form of shares, all of the net gains can be deferred with incorporation relief.

Note 2: The net chargeable gains are deferred. BADR is postponed until the sale of the shares providing the conditions are met when the shares are sold.

Base cost of shares received by Barbara

	£
Market value of 200,000 shares allotted	200,000
Less: Incorporation relief	(94,835)
Base cost	105,165

(ii) **Sale of shares in Bangle Ltd**

Share pool	Number	Cost £
Shares acquired	200,000	105,165
Disposal	(80,000)	(42,066)
	<hr/>	<hr/>
Balance carried forward	120,000	63,099
	<hr/>	<hr/>
		£
Sale proceeds		90,000
Less: Cost (see above)		(42,066)
		<hr/>
Chargeable gain		47,934
Less: AEA		(6,000)
		<hr/>
Taxable gain		41,934
		<hr/>
Capital gains tax (£41,934 × 10%)		4,193
		<hr/>

As Barbara holds at least 5% of the shares, is an employee (assuming she carries on running the business) and has held the shares and the business for a combined period of at least two years, BADR will be available on the sale of the shares.

(b) **Chargeable gain on disposal of the business**

	£
Net chargeable gains before reliefs (as before)	94,835
Less: Incorporation relief	
– limited to proportion of consideration received in the form of shares: (£94,835 × £150,000/£200,000)	(71,126)
	<hr/>
Gain qualifying for BADR	23,709
	<hr/>

Base cost of shares received by Barbara

	£
Market value of 150,000 shares allotted	150,000
Less: Incorporation relief	(71,126)
	<hr/>
Base cost	78,874
	<hr/>

Sale of shares in Bangle Ltd

Share pool	Number	Cost £
Shares acquired	150,000	78,874
Disposal	(80,000)	(42,066)
	<hr/>	<hr/>
Balance c/f	70,000	36,808
	<hr/>	<hr/>
		£
Market value (as sale at under-value to connected person)		90,000
Less: Cost		(42,066)
		<hr/>
		47,934
Less: Gift holdover relief (balancing figure)		(9,000)
		<hr/>
Chargeable gain (W) qualifying for BADR		38,934
		<hr/>

Working: Sale of shares

If there is a sale at undervaluation, a gain arises at the time if the actual consideration received is in excess of the original cost.

	£
Actual consideration	81,000
Less: Original cost	(42,066)
	<hr/>
Gain after gift holdover relief	38,934
	<hr/>

(c) Alternative method of deferring gains on incorporation

Barbara can defer gains on incorporation by using the gift holdover relief provisions instead of incorporation relief.

She can do so by either:

- ensuring she does not satisfy the conditions for incorporation relief, or
- she can satisfy the conditions and elect to disapply incorporation relief.

If the gift holdover relief route is taken, Barbara can gift the individual business assets to the company.

The gain on the freehold premises could be deferred against the market value of the freehold premises at acquisition. The gain on the shop-fitting is exempt as both cost and proceeds do not exceed £6,000. There is an allowable loss on the shop front and canopy which would be set against other gains.

The property could be retained by Barbara personally, to avoid stamp duty land tax and double charges to CGT in the future (on the sale of the property by the company and the sale of shares), but should not be rented to the company as this could restrict BADR on a future disposal of the property if sold as part of the disposal of the company shares.



Dafydd and Myfanwy

Answer 1 – Chapter 23

(a) Chargeable gains taxed on the partners

The capital gains of £197,000 arising on the disposal of the business will be split between the partners in their PSR:

	£
Dafydd (40%)	78,800
Myfanwy (60%)	118,200

Chargeable gains for 2023/24 are as follows:

Dafydd – gains qualifying for BADR	£78,800
Myfanwy – gains qualifying for BADR	£118,200

(b) Loss relief options

There are two possible ways that the partnership loss can be relieved.

- (i) A claim can be made against total income for the tax year 2023/24 and/or 2022/23.

Subject to this claim being made, it would then be possible to extend the claim against chargeable gains of the same year.

- (ii) Terminal loss relief (TLR) can be claimed.

The final trading income assessments will be split between the partners as follows:

	Dafydd 40%	Myfanwy 60%
	£	£
2020/21	7,600	11,400
2021/22	7,800	11,700
2022/23	6,080	9,120
2023/24	(14,800)	(22,200)

The most beneficial loss relief claim available to Dafydd would appear to be a terminal loss claim to carry back the loss on a LIFO basis against trading income only in the tax year 2022/23 first, then 2021/22 and the balance in 2020/21.

This would save income tax at 20% in each year and not waste the PA.

He could make a claim against his total income of £18,930 (£6,080 + £12,850) for the tax year 2022/23, but this would waste some of his PA.

A claim against his chargeable gains for the tax year 2023/24 would only save 10% tax, as the gains qualify for business asset disposal relief.

Myfanwy could also make a terminal loss claim, but this would waste her PAs for several years and save no tax.

She would be advised to make a claim against her total income of £3,850 (bank interest) for the tax year 2023/24. This saves no tax, as the income is covered by her PA, however it allows her to then claim loss relief of £18,350 (£22,200 – £3,850) against her chargeable gains for the tax year 2023/24 (i.e. £5,500 cottage and £118,200 partnership share).

Dafydd – taxable income and taxable gains

	2020/21	2021/22	2022/23	2023/24
	£	£	£	£
Trading income	7,600	7,800	6,080	0
Less: TLR	(920)	(7,800)	(6,080)	(0)
	<hr/>	<hr/>	<hr/>	<hr/>
	6,680	0	0	0
Employment income	7,350	12,650	12,850	0
	<hr/>	<hr/>	<hr/>	<hr/>
	14,030	12,650	12,850	0
Less: PA	(12,570)	(12,570)	(12,570)	0
	<hr/>	<hr/>	<hr/>	<hr/>
Taxable income	1,460	80	280	0
	<hr/>	<hr/>	<hr/>	<hr/>
				£
Chargeable gains				78,800
Less: AEA				(6,000)
Less: Capital loss b/f				(25,000)
				<hr/>
Taxable gains				47,800
				<hr/>

Myfanwy – taxable income and taxable gain

	2020/21	2021/22	2022/23	2023/24
	£	£	£	£
Trading income	11,400	11,700	9,120	0
Bank interest	0	0	0	3,850
	<hr/>	<hr/>	<hr/>	<hr/>
	11,400	11,700	9,120	3,850
Less: Loss relief				(3,850)
Less: PA	(11,400)	(11,700)	(9,120)	(wasted)
	<hr/>	<hr/>	<hr/>	<hr/>
Taxable income	0	0	0	0
	<hr/>	<hr/>	<hr/>	<hr/>

Chargeable gains in 2023/24

	£	£
Gains not qualifying for BADR:		
Gain on cottage		5,500
Gains qualifying for BADR:		
Gain on partnership	118,200	
Less: Balance of trading loss		
((£22,200 – £3,850) = £18,350)	(12,850)	(5,500)
AEA	(6,000)	(0)
	<hr/>	<hr/>
Taxable gain	99,350	0
	<hr/>	<hr/>

The taxable gain is subject to 10% CGT.

Note: The trading loss is set off against gains not qualifying for BADR first.



Aisling

Answer 1 – Chapter 24

The effect of the transactions on Test Valley Ltd:

June 2021 (y/e 31.12.21)	<ul style="list-style-type: none"> Company liable to pay tax equal to 33.75% of the loan outstanding on corporation tax due date within nine months of the end of the AP (i.e. on 1 October 2022) $(£72,000 \times 33.75\%)$ 	£24,300
January 2023 (y/e 31.12.23)	<ul style="list-style-type: none"> Company becomes entitled to repayment of tax to extent loan repaid (i.e. $£20,000 \times 33.75\%$) repayment is due on 1 October 2024 	£6,750
March 2024 (y/e 31.12.24)	<ul style="list-style-type: none"> Company becomes entitled to repayment of tax on the loan w/off (i.e. $£52,000 \times 33.75\%$) repayment is due 1 October 2025 	£17,550

The effect of the transactions on Aisling:

June 2021	• If interest is charged at less than the official rate of 2.25%, taxable income arises. This income is calculated in the same way as an employment income loan benefit however, as Aisling is not an employee this is taxed as a dividend.	
March 2024	• Loan waived = treated as dividend payment in 2023/24.	
		£
	• Include in income tax computation as dividends	52,000
		<hr/>
		£
	• First £1,000 tax at 0%	0
	• Next £44,140 (£125,140 – £80,000 – £1,000) tax at 33.75%	14,897
	• Remaining £6,860 (£52,000 – £44,140 – £1,000) tax at 39.35%	2,699
	• Extra tax due to loss of PA (Note) (£12,570 × 40%)	5,028
		<hr/>
	• Extra income tax payable	22,624
		<hr/>

Note: The personal allowance in the tax year 2023/24 will be lost as Aisling's adjusted net income will exceed £125,140, and part of the dividend will fall into the additional rate band.

If interest had been charged at less than 2.25%, the income arising on the equivalent of the loan benefit would have already used some of the dividend nil rate band in the tax year 2023/24, and so more tax would be due at 39.35% on the loan waiver.

As Aisling is not an employee of Test Valley Ltd, no NIC will be due on the loan waiver.



Bintou

Answer 2 – Chapter 24

(a) Transaction treated as a distribution

	£
Dividend	630,000
	<hr/>
Income tax	
First £1,000 × 0%	0
Remaining £629,000 × 39.35%	247,512
	<hr/>
	247,512
	<hr/>

The amount to be treated as a dividend is the difference between the sale proceeds and the amount originally subscribed (the term subscribed at par means Bintou paid nominal value).

The dividend is therefore £630,000 ($100,000 \times £7.30 = £730,000 - £100,000$).

(b) Transaction not treated as a distribution

	£
Proceeds	730,000
Less: Cost	(100,000)
	<hr/>
Capital gain (Note)	630,000
Less: AEA	(6,000)
	<hr/>
Taxable amount	624,000
	<hr/>
Capital gains tax @ 20%	124,800
	<hr/>

Note: As Bintou did not work for the company, business asset disposal relief is not available.

(c) Effect of satisfying the capital treatment conditions

The purchase of a company's own shares is always treated as a distribution unless all of the capital conditions are satisfied.

The taxpayer cannot choose which method applies.

If all of the conditions are satisfied, the effect is that income converts into a capital gain.

As can be seen by the question, this is advantageous as CGT is only charged at 20% compared to 39.35% for income tax (on all but the first £1,000 of dividends).

In an exam question, consider the effects of both situations.

**Dulce****Answer 3 – Chapter 24****(a) (i) Taxation as a sole trader**

Dulce's income tax:

			£
Trading income			85,000
			<hr/>
Income tax			
£		£	£
37,700	× 20%		7,540
47,300	× 40%		18,920
			<hr/>
85,000			26,460
			<hr/>
Dulce's national insurance contributions:			
Class 2 (52 × £3.45)			179
Class 4			
(£50,270 – £12,570) × 9%		3,393	
(£85,000 – £50,270) × 2%		695	
		<hr/>	4,088
			<hr/>
Dulce's total IT and NIC payable			30,727
			<hr/>

Note: The personal allowance is offset against Dulce's property income of £12,570.

(ii) **Taxation as a company, drawing a dividend of £21,822**

Company's corporation tax	£	£
TTP	85,000	
	<hr/>	
Corporation tax at 25%		21,250
Less: Marginal relief		
$(£250,000 - £85,000) \times 3/200$		(2,475)
Dulce's income tax:		
Dividend income	21,822	
	<hr/>	
Income tax first £1,000 \times 0%	0	
$(£20,822 \times 8.75\%)$	1,822	
	<hr/>	
Income tax payable		1,822
		<hr/>
Total tax payable		20,597
		<hr/>

National insurance:

No NICs is payable on dividends

(iii) **Taxation as a company, drawing gross salary of £27,194**

Company's corporation tax:

	£	£
Trading income	85,000	
Less: Salary	(27,194)	
Employer's NIC		
$(£27,194 - £9,100) \times 13.8\%$ (Note)	(2,497)	2,497
	<hr/>	
TTP	55,309	
	<hr/>	
Corporation tax at 25%		13,827
Less: Marginal relief		
$(£250,000 - £55,309) \times 3/200$		(2,920)
Dulce's income tax:		
Employment income	27,194	
	<hr/>	
Income tax $(£27,194 \times 20\%)$		5,439
Dulce's National Insurance:		
Class 1 $(£27,194 - £12,570) \times 12\%$		1,755
		<hr/>
Total tax payable		20,598
		<hr/>

Note: The employment allowance would not be available to offset against employer's NICs as this is a company in which Dulce, as a director, is the only employee earning over £9,100.

Comparison of taxation

The main difference between the taxation of a sole trader and a company is that income tax and NICs are due on all of the profits of a sole trader, whereas although all of the profits of a company are charged to corporation tax, only profits withdrawn from the company are charged to income tax.

Additionally, NICs are only payable on salary, not on dividends.

However, in this example the total tax due in both cases is virtually the same.

Tutorial note

Dulce will need to take a dividend of £21,822 to receive a net cash receipt of £20,000.

This is because the dividend will suffer no income tax on the first £1,000, but thereafter suffers tax at 8.75% as Dulce will be a basic rate taxpayer.

Therefore, the dividend required is calculated as follows:

$$D - ((D - £1,000) \times 8.75\%) = £20,000$$

$$D - 0.0875D + £87.50 = £20,000$$

$$0.9125D = £19,913$$

$$D = £21,822$$

Note: The question gives the amount of dividend to be paid, therefore the above calculation is for tutorial purposes only to prove that Dulce's net income will be £20,000.

Dulce will need to take a gross salary of £27,194 to receive a net salary of £20,000.

This is because the net salary is after deducting income tax of 20% on the gross salary (G) and after deducting NICs of 12% on (G - £12,570).

Therefore, the gross salary is calculated as follows:

$$G - (G \times 20\%) - ((G - £12,570) \times 12\%) = £20,000$$

$$G - 0.2G - 0.12G + £1,508 = £20,000$$

$$0.68G = £18,492$$

$$G = £27,194 (£18,492 \div 0.68)$$

Note: The question gives you the gross salary to use in the computation. The above computation is for tutorial purposes only to prove that the net income Dulce will receive is £20,000 (i.e. the same as the net income received if a dividend of £21,822 is paid).

(b) Implications of equity and loan finance

(i) From the company's point of view

Equity

- Fees incurred in issuing share capital are not an allowable deduction against trading profits.
- The cost of making distributions to shareholders are disallowable.
- The dividends themselves are not allowable.

Loan finance

- Interest on loans taken out to finance the business is deductible from trading profits.
- Capital costs, for example loans issued at a discount, are deductible from trading profits, where the loan finance is used for trade purposes.
- Incidental costs of obtaining medium or long term business loans and for issuing loan stock where the funds are used for trade purposes are deductible from trading profits.

(ii) From an individual investor's point of view

Equity

- If the investor is an individual, the dividends received are taxed on the excess over the first £1,000 at 8.75%/33.75%/39.35% depending on whether the individual is a basic/higher/additional rate taxpayer.
- There will be a chargeable gain or loss on the disposal of the shareholding.

Loan finance

- If the investor is an individual, interest received will be charged to income tax at 40%/45%, to the extent that the individual is a higher/additional rate taxpayer.
- Usually the original creditor will not realise a gain or loss when the debt is disposed of, however a debt on a security can result in a capital gain or a capital loss.

(c) Pension options available

- Dulce could invest in a personal pension. She can invest up to a maximum of £25,000 (100% of earnings) in the tax year 2023/24 and obtain tax relief.

This amount is paid net of basic rate tax, and the basic rate band is extended by the gross payment when calculating her income tax liability to obtain higher rate relief.

Dulce's dividends do not count as earnings for pension purposes.

**Ken and Cindy****Answer 1 – Chapter 26****(a) (i) Ken's VAT registration**

Traders become liable to register for VAT at the end of any month if the value of taxable supplies in the previous 12 months > £85,000.

Month to	£
31 March 2023	36,800
30 April 2023 ($£72,600 \div 3$)	24,200
31 May 2023 ($£72,600 \div 3$)	24,200
	<hr/>
	85,200
	<hr/>

Ken will therefore be liable to register for VAT from 31 May 2023, and he must notify HMRC by 30 June 2023.

Ken will be registered from 1 July 2023.

(ii) Effect of VAT registration on Ken's customers

Once Ken is registered, he will have to charge output VAT on his sales.

If his customers are not VAT registered, which seems likely given that he trades from a market stall, then this VAT will represent an extra cost for them.

Ken may be forced to reduce his prices if this makes his business uncompetitive.

Any customers who are VAT registered will be able to claim back the VAT charged by Ken.

(iii) **Suitability of special accounting schemes**

Flat rate scheme

Based on his current levels of sales, Ken will be unable to join the flat rate scheme, as he will have annual sales revenue of more than £150,000.

Cash accounting scheme

Ken would be eligible to join the cash accounting scheme, as his taxable turnover will not exceed £1,350,000 p.a.

However, the cash accounting scheme is most suited to businesses that have a high level of credit sales, as it avoids the need to pay VAT before cash is received from customers.

As Ken's sales are likely to be cash sales, there would be no benefit from joining the cash accounting scheme.

Annual accounting scheme

Ken could join the annual accounting scheme, as his taxable turnover will not exceed £1,350,000 p.a.

This scheme is likely to be beneficial, as it will mean that Ken will only have to submit one VAT return every year, thus reducing the administrative burden of being VAT registered.

VAT will be payable by instalment during the year, with a balancing payment due with the VAT return two months after the year end.

(b) **Cindy**

	Total	Recoverable	Irrecoverable
	£	£	£
Relating to taxable supplies	25,575	25,575	
Relating to exempt supplies	15,400		15,400
Relating to overheads (W)	30,800	21,560	9,240
	<u>71,775</u>	<u>47,135</u>	<u>24,640</u>

Cindy's deductible input VAT is therefore £47,135.

Working: Split of non-attributable VAT

Taxable % apportionment

$= £275,000 \div (£275,000 + £120,000) \times 100 = 70\%$ (rounded up to whole %)

$£30,800 \times 70\% = £21,560$

$£30,800 \times 30\% = £9,240$

De minimis test

The total input VAT, (total input VAT less input VAT directly attributable to taxable supplies), and (input VAT relating to exempt supplies), are all greater than £625 per month on average, therefore none of the de minimis tests are satisfied.

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